Supreme Court, U. S.
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# Supreme Court of the United States

No. 77-844

MONONGAHELA POWER COMPANY,
*Petitioner,*

v.

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,
*Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

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THE STATE OF WEST VIRGINIA

The petitioner, Monongahela Power Company, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Supreme Court of Appeals of the State of West Virginia entered in this proceeding on September 12, 1977.

## OPINION BELOW

The opinion of the Supreme Court of Appeals of West Virginia and the opinion of the Public Service Commission of West Virginia (both opinions are unreported) appear in the Appendix hereto.

## JURISDICTION

The judgment of the Supreme Court of Appeals of the State of West Virginia was entered on September 12, 1977. This petition for *certiorari* was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U. S. C. § 1257(2) and (3).

## QUESTIONS PRESENTED

1. Whether rates imposed on petitioner by the West Virginia Public Service Commission (in a decision which the West Virginia Supreme Court of Appeals declined to review) which will make it impossible for petitioner to maintain its credit and attract capital and may legally prohibit petitioner from issuing any further first mortgage bonds or further preferred stock, constitutes an unconstitutional taking of petitioner's property without due process of law, particularly when such rates were based upon obvious errors of law on the part of the Commission, namely the mistaken view that the coverage requirements contained in petitioner's controlling corporate documents were not binding and the conclusion that the Commission need not grant full rate relief in this case because of the pendency of a subsequent case.

2. Whether West Virginia Code, Chapter 24, Article 5, Section 1, which provides for discretionary review only of orders of the West Virginia Public Service Commission, including orders fixing rates for utility services, denies due process of law to utilities subject to the jurisdiction of the West Virginia Public Service Commission and particularly this petitioner.

## STATUTORY PROVISION INVOLVED

West Virginia Code, Chapter 24, Article 5, Section 1:

§ 24-5-1. Review of final orders of commission.

Any party feeling aggrieved by the entry of final order by the commission, affecting him or it, may present a petition in writing to the Supreme Court of Appeals, or to a judge thereof in vacation, within thirty days after the entry of such order, praying for the suspension of such final order. The applicant shall deliver a copy of such petition to the secretary of the commission before presenting the same to the court or the judge. The court or judge shall fix a time for the hearing on the application, but such hearing,



unless by agreement of the parties, shall not be held sooner than five days after its presentation; and notice of the time and place of such hearing shall be forthwith delivered to the secretary of the commission, so that the commission may be represented at such hearing by one or more of its members or by counsel. If the court or the judge after such hearing be of the opinion that a suspending order should issue, the court or the judge may require bond, upon such conditions and in such penalty, and impose such terms and conditions upon the petitioner, as are just and reasonable. For such hearing the commission shall file with the clerk of said court all papers, documents, evidence and records or certified copies thereof as were before the commission at the hearing or investigation resulting in the entry of the order from which the petitioner appeals. The commission shall file with the court before the day fixed for the final hearing a written statement of its reasons for entry of such order, and after arguments by counsel the court shall decide the matter in controversy as may seem to be just and right.

## STATEMENT OF THE CASE

On January 30, 1975, Monongahela Power Company (hereinafter "Monongahela") filed with the West Virginia Public Service Commission (hereinafter "Commission") its tariff desiganted P.S.C. W.Va. No. 20, cancelling P.S.C. W.Va. 19, stating increased rates and charges for furnishing electric service in the entire territory served by it in West Virginia, the new tariff to become effective March 1, 1975.

The test year upon which the filing was based was the twelve months ended September 30, 1974. Additional revenues of $30,909,610 annually were reflected in the proposed rates and supported in the filing.

By order dated February 12, 1975, in accordance with West Virginia regulatory practice, the Commission made

Monongahela respondent to the proceeding, suspended the new tariff and use of the rates and charges proposed therein until June 28, 1975, and conditioned the subsequent use of those increased rates and charges upon the filing by Monongahela of a bond in the amount of $31,000,000 to secure any eventual refund.

Monongahela filed the required $31,000,000 bond in this case and the increased rates, amended to reflect the rolled-in amount of the reasonable level of fossil fuel costs pursuant to the Commission's order in Case No. 8234,* were permitted to go into effect under bond on June 28, 1975.

By its June 5, 1975 order, the Commission established notice requirements and set this proceeding for hearing. Required notice was thereafter given; and the proceeding came on for hearings before the Commission in Charleston on August 21, 1975; March 22, 23, and 24; May 4, 5, 6, 7, 17, and 18, 1976; and in Clarksburg on October 24, 1975.

The filing of briefs to the Commission was concluded on December 13, 1976, and the Commission's decision was rendered on March 18, 1977, some twenty-six months after the filing and more than twenty-nine months after

*On February 20, 1975, the Commission issued its order in Case No. 7945, et al., in which it directed Monongahela Power and other electric utilities subject to the Commission's jurisdiction, to terminate the use of fuel adjustment clauses in their tariffs and to file, effective April 1, 1975, revised tariff sheets rolling into the Commission-approved base rates a projected reasonable level of fossil fuel costs. On March 24, 1975, Monongahela Power Company filed revised rates in response to such order incorporating its projected fuel costs into the basic rate structure; and the then existing rates so revised became effective on April 1, 1975, subject to review and refund. An amendment to the rates which are the subject of this case was also filed.



the test year. The Commission allowed increased rates and charges over previous rates and charges in the amount of $9,037,286. The effect of the Commission's order was to grant Monongahela only 29% of its requested rate relief. The record shows that by so doing it deprived Monongahela of any reasonable prospect of financing its essential construction program.

A Petition For Rehearing, Reargument, and Reconsideration was filed by Monongahela on March 28, 1977 which, among other things, specifically showed that under then-existing circumstances Monongahela could not, unless additional rate increases were allowed, maintain its credit and attract capital on a reasonable basis and in all probability could not finance the construction of facilities (commitments for which must be made in 1977 and 1978) necessary to meet the needs of its customers for electric service in the 1980's. The Commission's order denying rehearing, entered on April 20, 1977, ignored the record which, among other things, showed construction programs totalling almost $400,000,000 for the years 1976 through 1980 and a lack of revenues to support the financing thereof. Indeed, that denial was based primarily on the pendency of another rate case.

On May 24, 1977, Monongahela filed a petition for appeal of said rate orders to the Supreme Court of Appeals of West Virginia pursuant to the West Virginia Code, Chapter 24, Article 5, Section 1. Briefs were filed, including supplemental briefs expressly requested by the Supreme Court of Appeals on the question of Monongahela's ability to maintain its credit and to attract capital. Oral argument was held before the Supreme Court of Appeals on July 12, 1977. By order of September 12, 1977, the Supreme Court of Appeals denied Monongahela's petition for appeal, i.e. declined to accept the case for hearing on the merits. See Appendix C, hereto.

The West Virginia Public Service Commission declined to stay its order pending review and the West Virginia Supreme Court of Appeals also declined to grant a stay. This had the effect of requiring Monongahela to refund approximately $60,000,000, including interest, to its West Virginia customers at the very time it was seeking judicial review.

## REASONS FOR GRANTING THE WRIT

### 1. The decision below raises a question of extreme significance to all utilities.

The basic question presented by this appeal is one of simple economics. The record shows, and no one disputes, that Monongahela Power Company is engaged in a continuing program of constructing facilities, including electric generating facilities. There is no dispute that such facilities are and will be required for the rendition of reliable electric service to the Company's customers in West Virginia and elsewhere. The record shows that Monongahela's internal generation of funds for construction is only about half of the amounts required. It is, therefore, similarly not disputed that the Company must engage, almost continuously, in raising significant amounts of capital to finance this construction program.

This Court has clearly held that a public utility is entitled to a return which will enable it to maintain its financial integrity and carry out its public service functions. In *Bluefield Waterworks and Improvement Company* v. *Public Service Commission*, 262 U. S. 679, 692-693 (1923), this Court said:

> "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general parts of the country on investments in other business undertakings which are attended by



> corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, *to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.*" (Emphasis supplied.)

In *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U. S. 591, 603 (1944), this Court again set the same standard, saying:

> "From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. * * * By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. *That return, moreover, should be sufficient to assure in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.*" (Court's citations omitted.) (Emphasis supplied.)*

The order of the West Virginia Public Service Commission here involved fails to meet this standard on its face. It set a level of rates so low that the Company's coverages* can be shown to be insufficient to permit the issuance of first mortgage bonds and preferred stock. This result is directly contrary to this Court's holdings in the *Bluefield* and *Hope* cases, and arises from an obvious error on the part of the West Virginia Public Service Commission which, in arguing that the Supreme Court of Appeals should not accept this case for review, asserted that the

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*The Company's earnings (as defined in its indenture) must be two times interest charges on existing and proposed first mortgage bonds or the proposed bonds cannot be issued. The requriement for issuance of preferred stock is one and one-half times.

coverage requirements in question are not "a law or regulation, or . . . requirement," but simply a "rule of thumb." *This is simply not true.* The record is clear that Monongahela's credit standing and ability to attract capital, as well as its legal rights under the governing corporate documents (which are also embodied in federal regulations) squarely depend upon what the Commission has erroneously passed over as a "rule of thumb." The fact that the West Virginia Public Service Commission could make this assertion demonstrates the essential error in this case and makes even more unlawful the refusal of the West Virginia Supreme Court of Appeals to review it.

Monongahela Power Company is a part of the Allegheny Power System and hence subject to regulation by the Securities and Exchange Commission (hereinafter, the "SEC") pursuant to the Holding Company Act of 1935, 15 U. S. C., § 79 *et seq.* Under that Act, Monongahela is prohibited from issuing or selling any security except in accordance with a "declaration" under 15 U. S. C., § 79(g). See 15 U. S. C., § 79(f).

Pursuant to 15 U. S. C., § 79(g), the SEC has issued regulations which, in effect, specify the kinds of transactions which the SEC will approve. The question of coverage with respect to first mortgage bonds is dealt with in the SEC's Statement of Policy Regarding First Mortgage Bonds Subject to the Public Utility Holding Company Act of 1935. Release No. 35-13105, February 16, 1956, 21 F. R. 1286. On the same date, the Commission issued its Statement of Policy Regarding Preferred Stock Subject to the Public Utility Holding Company Act of 1935, Release No. 35-13106, 21 F. R. 1288.* The full text of these releases, as

*The requirements imposed by these Statements of Policy were already to be found in the indentures and charters of most utilities and were, therefore, binding on the companies as a matter of corporate law. In a sense, the Commission's Statements simply reflected the facts of life in the financial market.



reported in 3 CCH Federal Securities Law Reporter, beginning at §§ 36,675 and 36,691, respectively, is attached hereto as Appendix D.

These Statements *require* the indenture and charter provisions already described. The basic principle of the Statement of Policy Regarding First Mortgage Bonds is set out in Regulation § 251.13105, which, in provisions relative to coverage, requiring what has been referred to as "two times coverage," reads as follows:

> (a) Additional bonds may be authenticated and delivered under the Indenture in a principal amount not in excess of
>
> (1) a like amount of cash deposited with the Indenture Trustee;
>
> (2) a like principal amount of retired bonds; or
>
> (3) sixty per centum (60%) of the bondable value of net property additions;
>
> *provided that net earnings available for the payment of interest* during any twelve (12) consecutive calendar months during the period of fifteen (15) calendar months immediately preceding the first day of the month in which application is made to the Indenture Trustee for the authentication and delivery of such additional bonds shall be *at least equal to twice the annual interest requirements* on all bonds authenticated and delivered under the Indenture and prior lien obligations which will be outstanding immediately after the authentication and delivery of such additional bonds. Notwithstanding any of the foregoing, no earnings test need be met if such additional bonds are to be authenticated and delivered solely for the purpose of refunding an outstanding series of bonds issued under the Indenture or prior lien obligations, bearing a higher interest rate than such additional bonds, or for refunding an outstanding series of bonds issued under the Indenture or prior lien obligations within two years of maturity." (Emphasis supplied.)

The Statement of Policy Regarding Preferred Stock has parallel provisions, which need not be quoted here. The coverage provision provides for 1.5 times annual interest and preferred stock dividends.

Monongahela's indenture and charter provisions are in conformity with these Securities and Exchange Commission requirements. Thus it is apparent that the West Virginia Public Service Commission, in setting Monongahela Power's rates for electric service to its West Virginia customers, *proceeded on a plainly erroneous premise*. It did not take the Company's coverage requirements into consideration, because, as it said, it thought they were just a "rule of thumb." This Court, however, has expressly held that it is not theory but the impact of a rate order which counts and that a utility *must* be allowed a rate sufficient to ensure its financial integrity, so as to enable it to maintain its credit *and to attract capital*. *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U. S. 591 (1944). Since it has *admitted* that it did not understand the coverage requirements imposed upon the Company by law, it is clear that the West Virginia Commission not only did not comply with the standards set forth by this Court, but did not understand what it was doing. Indeed, the Commission (and the Supreme Court of Appeals by refusing to reverse) went so far as to find that normalization of deferred tax treatment benefits and the inclusion of construction work-in-progress in the rate base were not required because of Monongahela's supposed "financial health," an astounding conclusion to be reached in the same case in which the Commission failed to provide sufficient rate relief to enable the Company to attract capital.

This is no minor problem. In order to continue to provide adequate electricity to its customers in its service area, Monongahela, and indeed virtually *all* utilities, must undertake continuing construction programs to replace and



expand capital facilities. In order to finance such construction, a utility must raise capital, primarily by selling bonds and preferred stock. However, as demonstrated above, a utility cannot sell additional bonds unless its current revenues cover the interest due on indebtedness two times, and it cannot sell additional preferred stock unless its current revenues cover the dividends due on its preferred stock one and a half times. Because the rates imposed by the West Virginia Public Service Commission, which the West Virginia Supreme Court of Appeals declined to review, did not allow Monongahela sufficient revenues to cover interest on bonded indebtedness and dividends on preferred stock at the above-required ratios, Monongahela is effectively prohibited from financing its future construction programs through sale of bonds or preferred stock.

When this was brought to the Commission's attention, by the Petition For Rehearing, the Commission responded with the argument that, since the Company has pending a subsequent application for rate relief and can put *those* requested rates into effect subject to refund (as it did its proposed rates in this case), the Company in fact has "coverages" sufficient to permit it to raise senior capital. This argument completely misconceives the realities of the situation. In the first place, the collection of increased rates from April 28, 1977 (the date they became effective subject to refund), in no way offsets the $60,000,000, including interest, which the Commission required Monongahela to refund to its customers even though Monongahela's attempt to secure judicial review was pending.

More important, the investment community has learned through past experience that little reliance can be placed upon West Virginia rates subject to refund. If the West Virginia Public Service Commission adheres to its view that the requirements of the Securities and Exchange Commission and of a utility company's bond indenture and

charter are simply "rules of thumb," it is highly unlikely that the investment community, or anyone else for that matter, will count on West Virginia rates subject to refund as having *any* degree of permanence.

Thus the Company is in an untenable position. It cannot do what it must do to provide reliable service which the Public Service Commission and the public expect to provide. With long lead times required for the construction of generating facilities (about six to ten years) and the urgent financial commitments that must be made long before such facilities produce revenues, the Commission's characterization of funds subject to refund, which can be later taken away, as sufficient support for the raising of capital cannot help but lead to evaporation of the Company's credibility in the capital markets and, as an inevitable result, the deterioration of its credit and ability to attract capital.

2. **West Virginia Code, Chapter 24, Article 5, Section 1, pursuant to which a utility may seek discretionary review only of orders of the West Virginia Public Service Commission, is unconstitutional.**

As shown, the West Virginia Public Service Commission proceeded on a plain and undisputed misapprehension as to the applicable law. This makes it even more unreasonable that the West Virginia Supreme Court of Appeals, to which the issue was clearly presented, declined to review the case on the merits.

This case does *not* present any question as to the reasonableness of the requirements of the Securities and Exchange Commission nor, for that matter, any issue at this stage as to the impact of such requirements on the ratemaking process. It presents the question whether a utility, whose rates have been set by a regulatory agency proceeding under a plain and admitted misapprehension as to the law, is entitled to have access to *some* court for judicial review of that agency's action.



This Court has expressly held that a utility is, under the Fourteenth Amendment of the United States Constitution, entitled to the independent judgment of a court on ratemaking questions. This would be true even where there was no admitted error. The fact that there *is* undisputed error in this case simply makes it more imperative that this Court provide Monongahela Power with relief. There is now no other court which can do so.

Many years ago, this Court ruled in *Ohio Valley Water Co.* v. *Ben Avon*, 253 U. S. 287 (1920), that when a utility appeals a state rate order to a court of law, the court must exercise "its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause, Fourteenth Amendment."* This doctrine was reaffirmed 16 years later in *St. Joseph Stock Yards Co.* v. *United States*, 298 U. S. 38 (1936).

Most jurisdictions provide for appeal as of right from rate regulatory orders by their various public service commissions. Thus the *Ben Avon* issue does not frequently arise. Regulation in West Virginia is an exception.

This discretionary appeal of Public Service Commission orders provided by West Virginia Code, Chapter 24, Article 5, Section 1, is the sole means by which the Commission's orders may be reviewed. Whether to accept an appeal under that statute is totally within the discretion of the West Virginia Supreme Court of Appeals. The Court need not exercise an independent review as to the law and the facts. See *Preston County Light and Power Company* v. *Public Service Commission*, 297 F. Supp. 759, 766 (S.D. W. Va. 1969), where the Court expressly de-

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*253 U. S., at 289.

scribed Chapter 24, Article 5, Section 1, as "not calling for an independent judgment as to both law and facts."

The West Virginia Supreme Court of Appeals has consistently declined to review rate orders of the West Virginia Public Service Commission. *In this case, it did so even though it was confronted with an undisputed error of law.* It even declined to grant a stay of a $60,000,000 refund pending appeal. Certainly, as applied, the West Virginia provision for discretionary review of orders of the Public Service Commission is in plain conflict with the doctrine of the *Ben Avon* case. This Court must grant relief and hold that public utilities in West Virginia are entitled to access to the judicial system.

## CONCLUSION

For these reasons, a writ of *certiorari* should issue to review the judgment and opinion of the Supreme Court of Appeals of the State of West Virginia.

Respectfully submitted,

*Of Counsel*

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## CERTIFICATE OF SERVICE

I hereby certify that, on this ..... day of December, 1977, three copies of the Petition For Writ Of Certiorari were mailed, United States postage prepaid, to Arnold O. Weiford, Esq. and Clement R. Bassett, Esq., Counsel for Respondent. I further certify that all parties required to be served have been served.

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# APPENDIX A

## PUBLIC SERVICE COMMISSION OF WEST VIRGINIA CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA at the Capitol in the City of Charleston on the 18th day of March, 1977.

**Case No. 8127**

MONONGAHELA POWER COMPANY,
a corporation.
In the matter of increased
rates and charges.

## PROCEDURE

On January 30, 1975, Monongahela Power Company, a corporation (hereinafter "Monongahela" or "The Company"), filed its tariff designated P.S.C. W.Va. No. 20, canceling P.S.C. W Va. No. 19, stating increased rates and charges in the approximate amount of $30.9 million, for furnishing electric service in the entire territory served by it in the State of West Virginia, to become effective March 1, 1975. The filing included accounting data for the twelve months ended September 30, 1974.

By order entered on February 12, 1975, Monongahela was made respondent to this proceeding and pending investigation, hearing and decision, the aforesaid revised tariff was suspended and the use of the rates and charges stated therein deferred until June 28, 1975. It was further ordered that such rates and charges not be placed into effect until a bond in the amount of $31,000,000, with interest thereon, be given.

By order dated June 3, 1975, respondent was required to enter into a bond with surety approved by the Com-

mission, in the amount of $31,000,000, with interest thereon at the prime bank rate as of the date of said bond, conditioned and approved as to sufficiency in form and manner of execution by the Attorney General of the State of West Virginia, as required by Chapter 6, Article 2, Section 7, of the Code of West Virginia, as amended, before Monongahela placed the proposed rates into effect on June 28, 1975. Also, by said order the matters involved herein were set for hearing to be held in the Commission's Hearing Room at the Capitol in the City of Charleston on August 4, 1975, and Monongahela was required to give notice of the filing of the aforesaid revised tariff and of the time and place of hearing, so that anyone interested could appear and make such objection thereto as deemed proper, said notice to be given by posting said order at each of its offices where bills for electric service are paid for a period of at least twenty days prior to August 4, 1975, for public inspection, and by publishing a copy of said order once a week for two successive weeks, the first publication to be made not more than thirty days nor less than fifteen days prior to August 4, 1975, in newspapers published and of general circulation in the Counties of Barbour, Braxton, Brooke, Clay, Calhoun, Doddridge, Gilmer, Grant, Greenbrier, Hancock, Harrison, Jackson, Lewis, Monongalia, Marion, Mineral, Nicholas, Pendleton, Pocahontas, Pleasants, Preston, Randolph, Ritchie, Roane, Taylor, Tucker, Tyler, Upshur, Webster, Wirt and Wood. By subsequent order dated June 5, 1975, the hearing date of August 4, 1975, was canceled and the hearing was reset for August 21, 1975. Proper notice was given in the aforementioned manner and hearing was held as scheduled.

By order entered on June 24, 1975, the Commission determined that interest at the sum of seven per cent be set for the bond to be given in this proceeding, in accordance with the provisions of the aforementioned statute.



On October 22, 1975, a petition to intervene was filed on behalf of the following petitioners: Alcan Aluminum Company, Amax Specialty Steel, American Cyanamid Company, Brockway Glass Company, Burdox, Inc., E. I. duPont de Nemours & Company, Fourco Glass Company, Globe Refractories, Inc., Johns - Manville Corporation, Owens-Illinois, Inc., and Wheeling-Pittsburgh Steel Corporation. By order entered on October 28, 1975, permission to intervene and participate in further hearings was granted to the intervenors.

Thereafter on October 31, 1975, intervenors, designating themselves as "West Virginia Multiple Intervenors", filed a motion to have supplementary hearings on specified dates and to rearrange the scheduling of hearings as previously set by the Commission. This motion was denied by order of November 18, 1975.

On February 2, 1976, Stern Brothers, Inc., filed a petition to intervene, this being after the case had been called for initial hearing, and after a substantial portion of the direct evidence and protest evidence had been adduced. By order of February 4, 1976, the requested right to intervene by Stern Brothers, Inc., was granted.

Hearings in this procedure were held on August 21, 1975, March 22, 23 and 24, May 4, 5, 6, 17 and 18, 1976, at Charleston and on October 24, 1975, at Clarksburg.

At the hearings held on August 21, 1975, and thereafter, Monongahela Power Company was represented by Willis O. Shay, Richard S. Weygandt, L. E. Dickinson and Richard H. Talbott, Jr., Attorneys at Law; Henry R. MacNicholas and John H. Tinney, Attorneys at Law, appeared for Weirton Steel Division of National Steel Corporation and the other industrial intervenors; Robert R. Rodecker, Attorney at Law, appeared for Appalachian Research & Defense Fund, Inc., and Mountain Community

Union; and James A. Carr, Attorney at Law, appeared for Stern Brothers, Inc. The following appeared as protestants: Jon Blair Hunter; Ms. Wendy DePue; Michael P. Harmon, representing Council of Senior West Virginians, Inc.; David Grubb, representing West Virginia Citizens Action Group; Mrs. Joan White and Ms. Amy Parks, representing United People Welfare Rights; and Ivan Hunter. The Commission staff was represented by E. Dandridge McDonald and Robert J. Zak, Legal Division; and A. Byron Carver, David J. Ellis and Laxmi N. Mehra, Division of Accounts, Finance and Rates. There were sixty-six letters of protest received, including one from a municipality, and several petitions.

The Company presented six witnesses and thirty-seven exhibits. Staff presented two witnesses and seven exhibits; West Virginia Multiple Intervenors presented one witness and two exhibits; and Stern Brothers, Inc., presented two witnesses and four exhibits, all of which are subject to a pending motion to strike.

After completion of the testimony and receipt of the transcript staff of the Commission moved to reopen the record for receipt of additional evidence and for the consideration of certain cost studies that were not called to staff's attention until after the evidentiary hearing herein was closed. This motion was denied in Commission's order of October 8, 1976, in which was set specific briefing dates and the case was finally submitted subject to receipt of briefs. The final brief was filed on December 13, 1976, and the matters herein taken under consideration.

## EVIDENCE

Monongahela Power Company is a wholly owned subsidiary of Allegheny Power System, Inc., a regulated public utility holding company. It provides electric service



in thirty-two Counties in West Virginia, having a total area of 11,300 square miles and a population of in excess of 630,000 people. The Company has approximately 250,000 retail customers in the West Virginia area and about 22,000 retail customers in the six Ohio Counties that it serves.

Monongahela has total ownership in power stations in West Virginia at Rivesville and at Willow Island. In addition it owns a substantial percentage interest in power stations in West Virginia situate at Albright, Fort Martin and Harrison Station. It also owns an interest in a generating station at Hatfield's Ferry in Pennsylvania and is participating in the construction of a new generation facility in Pleasants County, West Virginia. The Company contends that from 1965 through 1974 the companies of the Allegheny Power System have spent approximately $736,000,000 in new power stations and between 1975 and 1983 they expect to spend an additional $1,895,115,000 for new power stations, which will be needed to meet the customer demand and to maintain reliability of service throughout the system. It alleges that it alone must spend nearly $400,000,000 between 1976 and 1980 for new construction and that as of 1974 it was able to generate internally only 28% of the money needed for the construction programs that were then in progress, which will compel them to turn to outside sources and public financing for the balance of the necessary funds.

In this proceeding Monongahela seeks an increase in rates and charges in excess of $33,000,000. The rates proposed by it will, according to staff, increase annual revenues by $35,942,140 and produce a rate of return of 13.76% upon its West Virginia business, this being substantially in excess of the Company's minimum rate of return sought herein of 9.9%.

At going level, the basic variances in the financial exhibits of the Company and Commission's staff are as follows:

| | Company | Staff |
|---|---|---|
| Operating Revenues | $110,959,854 | $137,086,284 |
| Operating Revenue Deductions | 87,554,146 | 110,078,163 |
| Net Operating Income | 23,405,708 | 27,008,121 |
| Rate Base | 392,929,077 | 333,465,570 |
| Rate of Return | 5.96% | 8.10% |

The Multiple Intervenors consisting of large industrial customers of Monongahela, whose electric power cost is a significant portion of their operating expenses, contend that rates for electric service should be designed to produce an equitable allocation of revenues among the utility's customers based upon the cost of service of each class of users.

Appalachian Research and Defense Fund, Inc., and Mountain Community Union take the position that the rates proposed by Monongahela are unjust and unreasonable in that they discriminate against low usage customers inasmuch as they are charged at a higher rate than the high use customers; that the record does not support the use of a declining block rate structure; that such structure is not cost justified, as required by West Virginia Statutes, and they propose the use of flat rates in the absence of cost justification of rates. These organizations also contend that the prompt payment discount set out in Company's application discriminates against the low income user.

Stern Brothers, Inc., alleges that the coal purchasing practices of Monongahela, particularly as they affect the Harrison Station, are improper and that its contracts with Pittsburgh Consolidated Coal Corporation and other com-



panies from which the Monongahela company buys fuel are such that the Company and the vendor can set the price of fuel at rates which are above the prevailing market price, all to the detriment of the consumer of the utility.

The number of protest letters and petitions received by the Commission and the statements of the protestants who appeared and testified in this case may be summarized as follows: (1) Persons living on fixed incomes, who contend that the requested rates would put electric service out of their financial reach. (2) Those who cited deficiencies in quality of service and slow response to out-of-service requests. (3) High rates presently being charged heating customers since elimination of water heating and space heating tariffs. (4) Collection and deposit practices of the Company, especially as they relate to low income users. (5) Fuel purchase costs and rate design that they contend do not favor the small user.

## DISCUSSION OF THE ISSUES

### RATE BASE

In addition to the rate base differences brought about by differences between staff's and Company's jurisdictional cost allocation methods, there are several substantial disagreements between the staff's and Company's development of rate base. These differences include the following areas:

#### Construction Work in Progress

The Company seeks to have added to its test year rate base the sum of ten million dollars for construction work in progress, this being an ongoing amount that it represents as being the funds obligated for construction work in progress at all times. This Commission has taken the position that the property under construction is clearly not rendering service to the consumer. A utility's rate base should be

its used and useful property devoted to rendering its regulated services. Such treatment is not unfair to the utility or its investors since it can capitalize funds used during construction and realize a return thereon after the construction is completed and property is placed into service. A return on new facilities under construction should be borne by those customers who receive the benefit of the use of such facilities; and, therefore, this item of construction work in progress will not be allowed as a part of the rate base in this case.

**Pollution Control Related Additions**

Monongahela has included a rate base adjustment in the amount of $18,859,828 in its report to reflect non-revenue producing items added through the date on which rates went into effect under bond in this case. In our decision in Case No. 7083 (Appalachian Power Company) this Commission did depart from a strict use of average rate base and exclusion of all construction work in progress from the rate base insofar as investment in electrostatic precipitators was concerned. The Commission's staff has calculated that similar treatment in this case would result in a rate base adjustment of $15,633,675, as compared to the above mentioned Company calculation of $18,859,828. In keeping with our decision in Case No. 7083, and for substantially similar reasons as outlined in the order in that case, we will allow Monongahela's investment in electrostatic precipitators in the rate base, and will therefore accept the staff adjustment of $15,633,675 as a proper inclusion in the rate base of this case. Our decision in this matter should be reflected by Monongahela Power Company through the proper elimination of any allowance for funds used during construction on these electrostatic precipitators subsequent to the date that rates in this case became effective.



**Fuel Inventory Adjustments**

There are two substantial fuel inventory adjustments at issue in this case. First, the Company has reflected an *upward* adjustment to average test year inventory levels amounting to $11,716,544. Staff, on the other hand, not only rejected the Company's adjustment, but *reduced* the rate base by $2,489,715 to reflect the average difference between the book fuel inventories and those fuel inventories that would have obtained had the Company used the same inventory method for bookkeeping as it did for its fuel adjustment clause.

Monongahela seeks a rate base adjustment calculated upon a projected increase in the quantity and cost of its coal stockpile. It asks for approval of an adjusted "normal" stockpile level at all of its generating stations priced at $1.00 per MBTU. Monongahela's calculation of this "normal" stockpile level is based upon an average of stockpile levels for the three years immediately preceding the test year.

Staff contends that the validity of the Company's calculation is based upon: (1) Monongahela's assumption that its coal stockpile can be expected to reach the pre-test year average and will be maintained at that level, and (2) Monongahela's repricing the entire fuel stockpile to $1.00 per MBTU, thereby departing from embedded costs and giving the coal stockpile "reproduction cost new" treatment. The staff further contends that both of the above stated assumptions are incorrect, thereby rendering the Company's calculation as invalid.

It appears that the average stockpile for the three years preceding the test year was approximately an 87 day coal supply. Following the test year, coal stockpiles remained substantially below the three year average.

It appears from the evidence adduced herein that Monongahela has made a projection of its stockpile size and of the cost per MBTU based upon future increases in quantity and price, neither of which has been realized. There is no evidence in the record that supports or justifies the Company's proposed adjustments, and we, therefore, will disallow the proposed $11,716,544 adjustment.

Staff evidence in this case has demonstrated that a substantial portion of the total book value of Monongahela's fuel inventory has been contributed by the Company's customers. As of September, 1974, the end of the test year in this case, the customer contribution toward book inventory was $4,961,387. There is little doubt that this figure would be higher were it calculated through March 31, 1975, the cutoff date for fuel adjustment clauses in the State of West Virginia. There has been no suggestion in this case, either by the staff, the Company or the intervenors, that since this customer contribution was never intended through our prior approval of fuel adjustment clauses, it should be refunded to Monongahela Power Company's customers. Indeed, the staff has taken a considerably softer approach by averaging the excess over the test year and recommending a $2,489,715 rate base reduction. The Commission feels that there is substantial evidence to support staff's position on this matter and will reflect a rate base reduction of $2,489,715 in this case; however, the total customer contribution to inventories through the termination of Monongahela's fuel adjustment clause should be further reviewed and considered in the next Monongahela Power Company rate case, which is now pending before this Commission.

**West Virginia and Pennsylvania Coal Properties**

Monongahela seeks inclusion of its investment in Allegheny Pittsburgh Coal Company, which owns undeveloped coal reserves in Pennsylvania and West Virginia, in its rate base in this case. The stock of Allegheny Pittsburgh Coal Company is substantially held by the power companies in the Allegheny Power System. Monongahela contends that such investment will enable the Company to be less dependent upon the price variations of the open coal market, that it will give it an improved bargaining position with its coal suppliers and assure it of coal in periods of fuel shortage.



This Commission has encouraged the purchases of fuel reserves by generating electric utilities or their investment in active subsidiary mining companies. We do not feel, however, that an investment in a subsidiary which has merely acquired coal reserves to be moved in an indefinite future period should be included in utility rate base. Monongahela Power Company can earn a return on its investments when the Allegheny Pittsburgh Coal Company property is developed. When such property is placed into operation the Company will be entitled and will be allowed to earn a return on its investment through its share of the reasonably allowable profits of the coal producer.

**Davis Power Project**

Monongahela contends that Davis Pump Storage properties should be given the rate base treatment of "property held for future use" and claims the amount of $2,147,156 to be included in its rate base. The Company requests this treatment since it has "a definite plan to complete this project". Staff, on the other hand, suggests that this matter is no different that other construction work in progress requests and should therefore be excluded from the rate base.

The Commission cannot agree with the approach of Monongahela Power Company on this item. Account No. 105 of the Commission's Uniform System of Accounts for

Electric Utilities requires the word "future" to relate to *immediate future* and not the *far distant future*. It is a matter of *common knowledge* that the Company and its predecessor companies have had, what it now calls, a "definite plan" for this project for a period of about fifty years. As of this date, construction has not been approved by appropriate governmental agencies. Therefore, we will reject the consideration of this item in the instant case.

**Allowance for Working Cash**

Both the staff and the Company used the 45-day rule as applied by the Federal Power Commission as a starting point for calculating the cash working capital allowance. They differ, however, as to whether or not an exception should be made for any reason to depart from this rule.

The staff has contended that there should be no inclusion of coal expense in the computation because of the time that elapses from the date of purchase to the date of payment for coal used by the utility. It suggests that this is substantially the same reason that purchased power is eliminated from operating expenses under the 45-day rule, and that the delivery payment dates for Monongahela's coal purchases justify similar treatment.

This Commission has historically followed the 45-day rule for the purpose of simplifying the determination of a reasonable cash working capital allowance; however, there is justification for reviewing the various components of cash working capital where there is evidence of a substantial payment lag with regard to major expenses. We have always excluded purchased power when determining a cash working capital allowance because of the lag between the time that power is purchased and it is paid for by the utility. The evidence in this case indicates that a similar lag occurs with regard to Monongahela's coal receipts and



payments. We would not be justified in requiring Monongahela's customers to provide working capital for fuel purchases which are not paid for until 45 days after the date of delivery. The Commission recognized the need to review the coal payment lag in Case No. 7025 (Monongahela Power Company) where we approved a cash working capital allowance based on 19 days fuel expense. The propriety of such a departure can be demonstrated by the significant percentage of total operating expenses represented in the Company's fuel expense accounts. As fuel expense becomes a progressively greater portion of the Company's total operating expenses this single departure from the expediency of the 45-day rule is warranted. For the above stated reasons we will accept the staff's methodology for calculation of a reasonable allowance for working cash in this case.

**OPERATION AND MAINTENANCE EXPENSES**

The differences between the staff's and Company's adjusted operation and maintenance expenses (excluding fuel) are minimal in comparison to the other issues in this case. One of the most substantial differences is the adjustment to reflect amortization of rate case expense. Both the Company and the staff used an estimated rate case expense of $250,000; however, the Company included in its cost of service the amortization of this expense over a two-year period whereas staff used a three-year period. Considering the current inflationary trend, the resultant frequency of rate applications and the amount of rate case expense, the Commission, after due deliberation, approves the Company's contention that a two-year amortization period is a fair and reasonable treatment of this item. We will, therefore, allow a provision for rate case expense in the amount of $125,000 in the cost of service developed for this case.

**Operation and Maintenance Expense on Pollution Facilities**

Both the Company and staff made an adjustment of $124,000 to reflect additional operation and maintenance expenses on the pollution control facilities which we have heretofore referred to and included in the rate base in this case. The record indicates that the $124,000 figure included only maintenance expense and that additional operating expenses of $233,000 should be reflected in the adjusted cost of service. The record further indicates that the staff is in agreement with the Company's contention even though the additional adjustment was not reflected in the staff report. Therefore, we will include the additional operating expense of $233,000 on a total company basis.

**Rental Expense**

The Company has reflected an adjustment of $20,409 on a total company basis to annualize rental expense at its Morgantown Service Center. The staff report did not reflect this amount; however, the staff, in its brief did not dispute the adjustment. We will, therefore, allow a $20,409 total company adjustment for this item.

**Fuel Expense**

As a result of the elimination of fuel adjustment clauses in the State of West Virginia, it is necessary for the Commission to determine a proper going level fuel cost to include in the operating expenses in this case. The staff presented considerable data with regard to fuel costs, fuel consumption, and average costs per million BTU and per KWH generated. The staff cost of service in this case includes a going level fuel expense rate of 97.24¢ per MBTU, a figure which equates to .98¢ per KWH generated.



In determining a proper going level fuel cost, the Commission is not bound by a rigid mathematical average such as that made by the staff, based on a historic period. Whether the historic data examined relate to periods prior or subsequent to the date rates go into effect under bond in any particular case is also not of particular importance insofar as making a determination of a reasonable going level expense. The Commission, upon reviewing the data which it has before it, must use its best judgment in determining a trended going level fuel cost. Due to the extremely volatile nature of fuel costs of electric utilities, the Commission cannot be bound by a rigid standard which attempts to precisely calculate this expense.

Possibilities of changing conditions of supply, the availability of low cost local coal, the contractual relationships between the utility and its many suppliers, the present and pending air pollution control requirements, the mix between purchases under long-term contracts, short-term contracts and on the spot market, generating efficiencies of the company's various generating units—these are some of the many factors which will ultimately affect the cost of coal purchased by an electric generating company.

Having reviewed the evidence in this case, and having considered the implications of the many supply questions which have been presented to us in this case, the Commission finds that the staff calculated 97.24¢ per MBTU is a reasonable level to include in the cost of service in this case.

Therefore, we will follow the staff's calculation with regard to both gross and net fuel cost per KWH as delivered to West Virginia jurisdictional customers.

Except as noted above, we will adopt the operation and maintenance expenses, as adjusted, included in the staff's Rule 42 Exhibit.

## TAXES

There are several areas of dispute between Monongahela Power Company and the Commission's staff with regard to the proper level of various taxes to be included in the cost of service in this case.

### Pennsylvania Corporate Net Income Tax

Monongahela Power Company holds an ownership interest of 27½% in the Hatfield Ferry Generating Station which is situate in the State of Pennsylvania. This Station is subject to corporate income tax in that State. This item appears in the respondent's Rule 42 Exhibit and is based upon production from that plant which is transmitted into the West Virginia portion of the Monongahela system. Staff has contended in this case that this should not be considered and should be denied for lack of evidentiary support.

We cannot agree with the staff's position on this matter insofar as it has presented no evidence to demonstrate that the Company has improperly assigned this tax to its West Virginia operations. The Commission finds that this adjustment is proper inasmuch as it is based upon generation of electricity from the Hatfield Ferry Station that was transmitted into West Virginia for distribution here. This is similar to the situation where a part of the ownership in West Virginia generating station is held by Monongahela's nonresident sister companies and their portion of the product is taxed in West Virginia and distributed for consumption in adjoining states.

### West Virginia Business and Occupation Tax

Both the staff and the Company adjusted Business and Occupation Tax, however, the staff included in its calculation the credit for industrial expansion which is claimed by Monongahela Power Company on its West



Virginia Business and Occupation Tax Return. The evidence indicates that the staff's calculation reflects the actual West Virginia Business and Occupation Tax payable, *based on actual tax returns filed.* Therefore, the Commission will accept the staff's calculation of a West Virginia Business and Occupation Tax liability, including the credit for industrial expansion.

### West Virginia Property Tax

Monongahela Power Company adjusted West Virginia Property Tax by $508,493 to reflect estimated future property taxes. The staff, on the other hand, used test year property taxes, unadjusted, for its going level and pro forma cost of service calculations. We will follow the staff approach and include actual test year property taxes in the cost of service developed in this case.

## COST APPORTIONMENT

In addition to the differences between staff and Company insofar as total Company cost of service determination is concerned, the Commission is also faced with the need to choose between two alternate jurisdictional cost apportionment approaches. Basically, Monongahela's witness, Mr. Gibson, sponsored cost apportionments which would assign rate base and expenses associated with a large portion of Monongahela's Federal Power Commission regulated business and revenues to West Virginia jurisdictional cost of service. While this method of cost allocation also assigns the revenue associated with this non-West Virginia jurisdictional business as credits to West Virginia cost of service, it leaves us with many questions and several possible problems. The Company argues that the firm FPC jurisdictional sales treated in this manner are profitable and, as such, are not requiring subsidization by West Virginia ratepayers. In addition, the Company imputed

additional revenue to these firm sales to further guarantee that they are not requiring subsidization. The Company further argues that the nonfirm FPC jurisdictional sales would not be made unless they were profitable and therefore will result in a benefit to West Virginia ratepayers. There is no attempt made by Monongahela to demonstrate the degree of profitability of these non-West Virginia jurisdictional sales by comparing the revenues associated therewith with properly allocated costs. While these sales may indeed be priced at a level sufficient to cover incremental production costs we have no method, under the Company's approach, to determine the extent to which they cover capacity costs that are properly allocable to them.

The staff witness, Mr. Ellis, included the volumes associated with non-West Virginia jurisdictional sales in the development of allocation factors. While the staff method excludes revenues from non-jurisdictional sales, it also assigns costs to those sales, thereby eliminating both non-West Virginia jurisdictional revenues and costs from consideration in this case.

In weighing the issues herein, the Commission recognizes the inherent impreciseness of cost allocation procedures. There is no single method that can be used universally which would guarantee a fair and equitable apportionment between groups, whether those groups be jurisdictions or classes within the same jurisdiction. The use of any particular method in this proceeding does not mean that it must be blindly followed in the future for this company or any other utility.

Staff witness Ellis pointed out that the Company's allocation method assigns costs associated with FPC jurisdictional sales to the West Virginia jurisdicitional cost of service and then offsets these costs, to an unknown degree,



by crediting the revenues to the cost of service. He pointed out that the Company methodology does not take into consideration any increase in revenues from cost-based non-firm contractual sales even though cost increases associated with these sales are projected at going level. The Commission agrees that once the decision is made to follow a particular cost allocation procedure, its logic must be carried through when considering cost of service adjustments.

Having considered the evidence presented to us in this case and the merits of the various arguments, the Commission will follow the procedures outlined by the staff in making jurisdictional cost apportionments.

## RATE OF RETURN

The record, in this case, includes rate of return recommendations from two witnesses; Joseph F. Brennen, on behalf of Monongahela Power Company, and Laxmi Mehra, on behalf of Commission's staff.

Schedule 12 of Mr. Brennen's Exhibit JFB-1, derives a bare cost of capital of 9.41%. To this, Mr. Brennen adds an allowance for attrition and lag of .5% to arrive at his calculated overall fair rate return of 9.91%. Mr. Brennen includes "cost-free" capital in the development of his capital structure ratios.

Mr. Mehra, using various methods, arrived at a recommended fair rate of return ranging from 8.0% to 9.0%. Mr. Mehra's capitalization ratios were different than Mr. Brennen's, mainly due to the treatment of cost-free capital.

Mr. Brennen testified that either approach, insofar as developing capitalization ratios, is "perfectly acceptable as a theoretical matter". Mr. Brennen further testified that

had he assumed that cost-free capital would be treated as a rate base reduction he would have calculated capitalization ratios substantially similar to Mr. Mehra's. The following table demonstrates the capitalization ratios and equated cost of capital as recommended by Mr. Brennen and Mr. Mehra:

| Mr. Brennen: | Ratio | Cost Rate | Weighted Cost |
|---|---|---|---|
| Debt | 53.4% | 7.375% | 3.94% |
| Preferred Stock | 11.2% | 6.750% | .76% |
| Common Equity | 31.4% | 15.0 % | 4.71% |
| Cost-Free Capital | 4.0% | -o- | -o- |
| Total | 100.0% | | 9.41% |

| Mr. Mehra — 1975 | Ratio | Cost Rate | Weighted Cost |
|---|---|---|---|
| Debt | 55.06% | 7.56% | 4.16% |
| Preferred Stock | 12.03% | 6.73% | .81% |
| Common Equity | 32.91% | 10.18%-14.32% | 3.35%-4.71% |
| Total | 100.00% | | 8.32%-9.68% |

As is evident, there is a little difference between Mr. Brennen and Mr. Mehra insofar as the cost rate of debt and preferred stock is concerned; however, there is a divergence of views with regard to the cost of common equity. Insofar as debt is concerned, Mr. Mehra actually arrived at a cost rate which is slightly higher than that used by Mr. Brennen.

In determining a proper rate of return on rate base, the Commission must consider all factors, not just a mathematical exercise deriving weighted cost based on capitalization ratios and cost of capital rates. The major variable, that being the cost of common equity, cannot be viewed at an isolated cost rate, but must be carefully weighed in view of all rate base and cost of service determinations.



Having thus reviewed the overall impact of our order the Commission finds that, on the basis of the record in this case and upon its informed judgment, the allowable rate of return on rate base for Monongahela Power Company in this case is 9.15%.

## FEDERAL INCOME TAX

### Consolidated Tax Savings

In arriving at the Federal income tax component of its cost of service, Monongahela Power Company deducted the average annual tax savings created by its joining in a consolidated tax return back through the year 1970. This procedure reflects average tax savings, from the consolidated tax returns, of $257,900.

Staff measures the savings based upon an average of the percentage savings for the years 1972, 1973 and 1974. In its calculation, staff eliminates those operating companies which had tax losses before arriving at the total tax liability on a consolidated filing basis. A comparison of the tax liability on a consolidated basis so calculated and the tax liability that would have been incurred on a separate return basis results in a percentage savings of 7.02% for the three year average.

Both the Company and the staff contend that they are following the Commission's treatment of this subject in Monongahela's prior rate case (Case No. 7025); however, the difference is that the Company is computing tax savings as a fixed dollar amount whereas the staff is deriving an effective tax rate which it maintains is representative of expected future effective Federal income tax rates.

This Commission has always used the staff method of calculating an effective tax rate to apply to pro forma

taxable income. Therefore, we will use the staff calculation of an effective tax rate based upon an average from the 1972, 1973 and 1974 Federal income tax returns.

**Normalization of Income Tax Deferrals Resulting From Liberalized Depreciation**

The Company, for the purposes of developing a Federal income tax liability to be used in this case, added back $2,909,134 to its Federal income tax to reflect normalization of tax deferrals resulting from the use of liberalized depreciation on post 1969 expansion utility property and a repair allowance. The staff did not follow the "normalization" approach, but instead reflected all statutory deductions including liberalized depreciation and the repair allowance in calculating a Federal income tax liability.

Staff objects to the "normalization" approach which requires present customers to pay a larger income tax component in their rates than is actually incurred by the Company. Staff further objects since funds collected from the current customers for future Federal income tax are themselves taxable and therefore only a portion of the capital so generated actually goes into the Company's reserve.

This Commission is well aware of all the many arguments with regard to "normalization" of tax benefits associated with liberalized depreciation. The question of tax savings versus tax deferral has been argued before the Commission on many occasions and has previously been fully considered by the Commission before its rejection of "normalization".

This Commission has approved "normalization" in the past where such treatment is required by statute, i.e., "normalization" of tax benefits of liberalized depreciation



on post tax 1969 expansion property when elections prohibiting "flow-through" were made. Whenever this approach is taken, however, the deferred taxes should be reflected for rate-making purposes as a reduction from the rate base. Whenever there has been no statutory obligation to "normalize" such as is on post 1969 non-expansion property and all pre 1970 property, we have, in the past, held that "normalization" is not proper and have required that the benefits of liberalized depreciation be "flowed-through" to the utilities' customers.

As is the case with so many issues which must be resolved by a regulatory commission in setting rates, the item of tax benefits arising from accelerated depreciation must be considered as an integral part of the overall cost of service; not as a totally separate item to be decided one way or the other irrespective of the Company's overall financial condition. *The Commission may, in certain instances, decide various issues differently on a company-by-company basis.* This is not inconsistent and is in keeping with the desired goal of reasonable regulation if it results in just and reasonable rate levels which guarantee the continuity of good service while neither rewarding a utility for poor and imprudent management or penalizing a utility for efficient management.

We perceive no logical reason to depart from our past decisions on this matter as to this particular Company in the circumstances of record. While the Commission may have in the past and may in the future depart from this position to alleviate financing problems or to avoid extreme economic difficulties, neither of these problems appear in the record of the instant proceeding. The Company's request to "normalize" current income tax benefits associated with liberalized depreciation is therefore denied and the benefits realized will be "flowed-through" to the ratepayers in this instance.

**Additional Depreciation for Income Tax Purposes**

Having decided to flow-through the tax benefits accruing from additional depreciation taken for tax purposes, the Commission is faced with the problem of determining the level of additional depreciation to include in the tax calculation for this case. The Company claimed additional depreciation on its West Virginia operations of $4,979,687. Staff, on the other hand, examined the relationship between book and tax depreciation for the years 1973 and 1974. In 1973 the depreciation for tax purposes was 1.55 times the depreciation for book purposes and in 1974 it was 1.54 times the depreciation for book purposes. Based on this analysis, the staff concluded that test year book depreciation expense should be increased 1.54 times to reflect test year tax depreciation. Using this approach the staff calculated that additional depreciation for tax purposes on the West Virginia portion of Monongahela Power Company's business should be $7,321,370, or $2,341,683 more than the additional depreciation used in Monongahela Power Company's exhibit.

The blame for this difference of opinion can be placed squarely on the fact that Monongahela Power Company did not file this proceeding on a calendar year, but used a test year ended September 30, 1974, making it difficult, if not impossible, to accurately determine the additional depreciation for tax purposes. The Company, after its initial filing, amended the amount which it claimed to be additional tax depreciation to $5,592,541. Since the test year used in this case did not coincide with a tax year both the Company and the staff are merely imputing an estimated amount of additional tax depreciation.

The Company calculation does recompute tax depreciation on the basis of the test year additions by month;



however, the Company method is deficient in that it disregards the "half year convention". Using the "half year convention" the Company should have calculated tax depreciation on all additions made prior to April 1, 1974, as though such additions had been made on October 1, 1973. The staff has taken the position that such a calculation would have indeed been an accurate reflection of additional depreciation for tax purposes since it would have treated the test year used in this case as a tax year. This treatment would have resulted in a higher tax depreciation difference than Monongahela's $5,592,541. There is no evidence in this record to indicate whether the difference between book depreciation and tax depreciation calculated using the "half year convention" would have been as high as the $7,321,370 reflected in the staff exhibit.

The record in this case indicates that the $4,979,687 tax deduction originally used by Monongahela Power Company is incorrect and insufficient. The record also seems to indicate that the $5,592,541 tax deduction used by Monongahela Power Company in its revised exhibit is incorrect and insufficient, although to a lesser degree. The record in this case does not clearly indicate whether the $7,321,370 tax deduction used by staff is excessive; however, the staff has indicated that it feels that a proper calculation, treating the year ended September 30, 1974, as a tax year for determining depreciation for tax purposes, would result in a deduction for this item somewhere between the $5,592,541 used by Monongahela Power Company and the $7,321,370 used by staff.

Since there is only a three-month difference between the bulk of the additions in the test year and October 1, 1973, which is the beginning of the test year, we will use $5,592,541 as additional depreciation for tax purposes in this case.

**Job Development Credits**

The Company has made a timely election regarding the application of this credit and it has been agreed between Monongahela and Commission staff that $4,210,060 should be added to staff's rate base and in addition the Federal income tax deduction associated therewith of $193,300 representing the current amortization of post 1970 investment tax credit should be reflected in the cost of service in this case. Therefore, we will not deduct deferred investment tax credit from the rate base in this case, but will reflect the amortization of investment credits over the lives of property upon which the credit was based.

Except for those departures heretofore noted we will follow the staff recommendations with regard to calculation of a net Federal income tax allowance in this case.

## RATE STRUCTURE

The Company takes the position that while the electric water heater rate was beneficial in the early 1960's, that because of the high rate of inflation, which has more than offset the efficiency gains realized through advancing technology, the utility is placed in a position where the special rates to owners of electric heaters are no longer justified. In its proposed rates at "Residential Service Rate – Schedule 'A'" it eliminates the water heater provision except for customers who were using this service on April 25, 1974. The Company in so limiting this tariff discriminates between the persons who enjoyed the benefits of the electric water heating rates and those who after April 25, 1974, applied for this service. The Commission, after considering the situation and reviewing cases decided in this and other jurisdictions relating to rate discrimination, finds that the portion of the Monongahela Power



Company tariff limiting the availability of the water heater service rate is not cost justified, that it is unreasonable and unjustly discriminatory. In reaching this decision we do not thereby give our approval to the utility subsequently phasing out the electric water heating rate but we do reject as discriminatory the portion of the same which seeks to make it unavailable to applicants for said service after the proposed cutoff date of April 25, 1974.

Another item within this classification is the time of application of the late payment penalty of ten days, as requested by respondent. The Commission has found this period to be too short in view of billing cycles and the postal delivery situation, and it, therefore, extends said time for application of the late payment penalty from ten to twenty days after the date of billing, this extension to apply to all of Monongahela's tariff sheets having a late payment penalty provision.

## COST OF SERVICE AND REVENUE DEFICIENCY

The respondent's cost of service, based on a 9.15% rate of return and developed in accordance with principles set forth in this order, is $146,123,570, and, after deducting revenues under prior rates at going level, we find a revenue deficiency of $9,037,286 (See Appendix I). We will, therefore, allow rates that will result in an overall increase of $9,037,286.

The Commission has received testimony from the Company, staff and intervenors with regard to rate design in this proceeding. We do not believe that the record indicates the need to depart from the Company's historic rate design in this instance, especially in the total absence of the presentation of a fully allocated cost of service study between *classes* of customers. Therefore, in order to substantially maintain the historic rate design, we will

order rates in this case using *base rates* approved in Monongahela's last case as a starting point to which we will add a fuel cost related increment which is equal at *all* energy consumption levels for *all* rate schedules (except to the extent that there is a variance in line loss and business and occupation tax applicable to each rate schedule) and an across the board *percentage* increase to cover additional non-fuel related costs. Rates will be designed to produce revenues equal to the total cost of service specified herein.

## FINDINGS

1. Respondent's rates and charges last approved by the Commission are unjust and unreasonable in that they will not produce sufficient revenues to enable the respondent to pay its reasonable and necessary operating expenses and taxes, provide for depreciation, and earn a fair return on its property used and useful in its public service business.

2. Respondent's rates and charges now in effect under bond are likewise unjust and unreasonable in that they would produce more revenues than are needed for the aforementioned purposes.

3. The portion of "Residential Service Rate – Schedule 'A'" that denies the electric water heating rate to persons who subscribed to the service after April 25, 1974, is unjust and discriminatory and should not be approved.

4. Respondent's delayed payment penalty provision (late payment charge) proposed in its tariffs should not become effective until twenty days after the date of the utility billing, this to apply to all tariff sheets having a late payment penalty provision.

5. The rates and charges hereinafter approved are just and reasonable in that they should produce revenues sufficient, but not more than sufficient, for the aforesaid purposes (Appendix II).



## ORDER

IT IS ORDERED THAT:

1. The rates and charges that respondent now has in effect under bond are hereby canceled and stricken from the tariff files of the Commission.

2. The rates set out in Appendix II that is hereto attached be approved, to become effective as of June 28, 1975.

3. The portion of "Residential Service Rate – Schedule 'A'" that denies electric water heating privileges to persons who subscribed to the service after April 25, 1974, be, and the same is, stricken from that tariff.

4. Respondent's delayed payment penalty provision (late payment charge) proposed in all tariffs where listed shall not become effective until twenty days after the date of billing.

5. The respondent shall refund to the persons or parties entitled thereto within sixty days of the date of this order the amount of excess collected under the rates placed into effect under bond and the amount which would have been collected under the rates that are herein approved, with interest thereon at the rate of seven per cent (7%) per annum until paid; that refunds of Five Dollars ($5.00) or less may be made by crediting the amount to the subscriber's account, and that as to amounts in excess of Five Dollars ($5.00) the refund shall be made by check. The calculation of refunds should be made on a monthly basis and in no case shall the respondent retroactively charge a customer, either through adjusted billing or offsets against refund amounts, in any months where the rates herein ordered exceed the interim rates. The respondent shall report to the Commission the amount

refunded, including the interest, the manner of refunding and the amount, if any, which it has been unable to refund.

6. Respondent shall file with the Commission tariff sheets stating its rates and charges as specified herein.

A COPY.

TESTE:

S. GROVER SMITH, JR.
*Secretary*



*APPENDIX I*

**MONONGAHELA POWER COMPANY**
**CASE NO. 8127**

**COST OF SERVICE AND**
**REVENUE DEFICIENCY AT 9.15%**

| | |
|---|---|
| **Cost of Service @ 9.15% Return** | |
| Allowance for Return | $ 30,856,050 |
| Operating Expenses | 82,254,555 |
| Depreciation Expense | 13,376,607 |
| Other Taxes — Before Additional B & O | 11,301,585 |
| Federal Income Tax | 7,891946 |
| Additional B & O Tax on Revenue Increase | 442,827 |
| Total Cost of Service | $146,123,570 |
| **Revenue Increase Required** | |
| Total Cost of Service @ 9.15% | $146,123,570 |
| Revenue at Going-Level | 137,086,284 |
| Additional Revenue Requirement | $ 9,037,286 |

*APPENDIX II*

**MONONGAHELA POWER COMPANY**
**CASE NO. 8127**

**RESIDENTIAL SERVICE RATE**
**SCHEDULE "A"**

**Rate** (For a single residence)

First 40 kilowatt-hours per month
$.06285 net ($.06785 gross) per kilowatt-hour
Next 50 kilowatt-hours per month
$.05130 net ($.05230 gross) per kilowatt-hour
Next 110 kilowatt-hours per month
$.03762 net ($.03862 gross) per kilowatt-hour
Next 350 kilowatt-hours per month
$.02863 net ($.02963 gross) per kilowatt-hour
Next 450 kilowatt-hours per month
$.02489 net per kilowatt-hour
Next 600 kilowatt-hours per month
$.02254 net per kilowatt-hour
Additional kilowatt-hours per month
$.02115 net per kilowatt-hour

When the customer uses an approved electric water heater as the sole means of heating water for the residence, and applies for special billing, the fourth block above of 350 kilowatt-hours will be billed at $0.02329 net ($.02429 gross) per kilowatt-hour. An approved type of water heater must have a capacity of at least 30 gallons and must be so arranged that it cannot impose a load greater than 5,500 watts. The tank must be insulated and all wiring and piping must be in accordance with the Company's specifications.

**Minimum Bill**

$2.50 net ($2.70 gross) per month for each single residence.



**Discounts**

The difference between the gross and net rates above specified shall constitute a discount for prompt payment if the bill is paid in full on or before the 20th day after that on which bill is rendered.

**GENERAL SERVICE RATE**
**SCHEDULE "B"**

**Rate**

First 50 kilowatt-hours per month
$0.06919 net ($0.07319 gross) per kilowatt-hour
Next 350 kilowatt-hours per month
$0.04738 net ($0.04838 gross) per kilowatt-hour
Next 600 kilowatt-hours per month
$0.04032 net ($0.04132 gross) per kilowatt-hour
All additional kilowatt-hours per month
$0.03497 net ($0.03597 gross) per kilowatt-hour

**Minimum Bill**

The minimum bill per month shall not be less than $3.45 net ($3.65 gross) nor less than $1.23 net ($1.28 gross) per kilowatt of capacity necessary to serve the customer. A kilowatt of capacity necessary to serve under this schedule shall be defined as the maximum number of kilowatt-hours used in the current month, or in any of the previous 12 months, divided by 120.

**GENERAL SERVICE RATE**
**SCHEDULE "C"**

**Rate**

Primary Portion: Kilowatt-hours in an amount equal to the product of the first 60 times the kilowatts of monthly billing demand:

$.05504 net ($.06004 gross) per kilowatt-hour

Secondary Portion: Kilowatt-hours in an amount equal to the product of the next 120 times the kilowatts of monthly billing demand:

For the first 840 kilowatt-hours $0.05055 net per kilowatt-hour

For all over 840 kilowatt-hours $0.02318 net per kilowatt-hour

Excess Portion: Remainder of energy used in excess of the primary and secondary portion, provided that not less than 840 kilowatt-hours have been billed in the secondary portion $.01784 net per kilowatt-hour

**Minimum Bill**

$1.55 net ($1.65 gross) per month per kilowatt of maximum billing demand established, which demand shall not be less than 50% of the kilowatt capacity necessary to serve the customer, or less than 10 kilowatts.

**Prompt Payment Discount**

The difference between the gross and net rates above specified shall constitute a discount for prompt payment if the amount is paid in full on or before the 20th day after that on which the bill is rendered.

**System Voltage Discount**

When service is furnished at the primary distribution system voltage and the customer owns and maintains the transformer installation, the following discount will be



allowed but in no case will the amount of the minimum bill hereby reduced.

For all kilowatts of demand $0.10 net per kilowatt

## CHURCH AND SCHOOL HEATING RATE SCHEDULE "CSH"

**Rate**

For all kilowatt-hours used per month
$0.02294 net per kilowatt-hour

## GENERAL SERVICE RATE SCHEDULE "D"

**Rate Per Month**

Demand Charge

First 300 kilowatts or less
$1,122.00 gross

Next 200 kilowatts
$2.711 gross per kilowatt

All over 500 kilowatts
$2.619 gross per kilowatt

All kilovars in excess of 35% of the current kilowatt billing demand
$ .25 gross per kilovar

Energy Charge

First 100,000 kilowatt-hours
$0.01593 gross per kilowatt-hour

Additional kilowatt-hours
$0.01454 gross per kilowatt-hour

**Minimum Monthly Bill**

The minimum monthly bill shall not be less than the highest of the following:

1. $1,122.00 gross, or,

2. $1.50 gross per KW of the highest billing demand established during the preceding 12 months, or,
3. $1.50 gross times 50% of the kilowatt capacity set forth in the Agreement.

**Prompt Payment Discount**

When the account is paid in full on or before the 20th day after that on which the bill is rendered, a discount of two percent will be allowed from the gross rate specified above.

## GENERAL SERVICE RATE SCHEDULE "GH"

**Rate**

First 300 kilowatt-hours or less per month
$0.06823 gross per kilowatt-hour

Next kilowatt-hours equal to 40 times the kilovolt-amperes of monthly billing demand
$0.04364 gross per kilowatt-hour

Next kilowatt-hours equal to 80 times the kilovolt-amperes of monthly billing demand
$0.03412 gross per kilowatt-hour

Additional kilowatt-hours per month
$0.01787 gross per kilowatt-hour

**Minimum Bill**

$1.28 gross per kilovolt-ampere of the billing demand for the current month.

**Prompt Payment Discount**

The gross rates specified above shall be subject to a discount of two percent if the account is paid in full on or before the 20th day after that on which the bill is rendered.



**System Voltage Discount**

When service is furnished at the primary distribution system voltage and customer owns and maintains the transformer installation, a discount of $0.10 per kilovolt-ampere (before prompt payment discount) of the billing demand for the current month will be allowed, but in no case will the amount of the minimum bill be hereby reduced.

## GENERAL POWER SERVICE RATE SCHEDULE "K"

**Rate Per Month**

| | | |
|---|---|---|
| Demand Charge | | |
| First 1,000 kilovolt-amperes of billing demand or less | $3,242.00 | gross |
| Additional kilovolt-amperes of billing demand | 2.29 | gross per kilovolt-ampere |
| Energy Charge | | |
| All kilowatt-hours | $ 0.01393 | gross per kilowatt-hour |

**Prompt Payment Discount**

2% of the monthly bill if paid in full within 20 days from the date thereof.

## LARGE POWER SERVICE RATE SCHEDULE "P"

**Rate**

| | | |
|---|---|---|
| Demand Charge | | |
| First 3,000 kilovolt-amperes of demand per month | $7,077.00 | gross |

| | |
|---|---|
| Next 14,000 kilovolt-amperes of demand per month | 2.096 gross per kilovolt-ampere |
| Additional kilovolt-amperes of demand per month | 1.903 gross per kilovolt-ampere |
| Energy | |
| First 1,500,000 kilowatt-hours per month | $.01365 gross per kilowatt-hour |
| All additional kilowatt-hours per month | .01258 gross per kilowatt-hour |

**Prompt Payment Discount**

2% of the monthly bill if paid in full within 20 days date thereof.

## PRIVATE OUTDOOR LIGHTING SERVICE RATE SCHEDULE "SL-P"

**Rate Per Month**

1. For Standard Open Type Incandescent Unit on 4-Foot Bracket:

   1,000 Lumen ( 100 c.p.) Lamp
   $ 2.80 Net per lamp

   2,500 Lumen ( 250 c.p.) Lamp
   $ 3.75 Net per lamp

   4,000 Lumen ( 400 c.p.) Lamp
   $ 5.35 Net per lamp



2. For Standard Semi-Enclosed Type Incandescent Unit on 4-Foot Bracket:

   2,500 Lumen ( 250 c.p.) Lamp
   $ 4.05 Net per lamp

   4,000 Lumen ( 400 c.p.) Lamp
   $ 4.65 Net per lamp

   6,000 Lumen ( 600 c.p.) Lamp
   $ 5.60 Net per lamp

3. For Standard Semi-Enclosed Type Mercury Vapor Unit on 4-Foot Bracket:

   7,000 Lumen ( 700 c.p.) Lamp
   $ 5.30 Net per lamp

4. For Standard Enclosed Type Mercury Vapor Unit on 8-Foot Bracket or less:

   11,000 Lumen (1100 c.p.) Lamp
   $ 6.50 Net per lamp

   20,000 Lumen (2000 c.p.) Lamp
   $ 8.55 Net per lamp

   53,000 Lumen (5300 c.p.) Lamp
   $14.85 Net per lamp

5. Floodlights (Standard) on Brackets:

| | |
|---|---|
| 11,000 Lumen | $ 6.50 Net per lamp |
| 20,000 Lumen | $ 8.55 Net per lamp |
| 53,000 Lumen | $14.85 Net per lamp |

6. Pole Top Mounted 7,000 Lumen Mercury Vapor Unit:

| | |
|---|---|
| On 15′ Steel Pole | $11.55 Net per lamp |
| On 20′ Steel Pole | $12.95 Net per lamp |
| On 14′ Aluminum Pole | $11.85 Net per lamp |
| On 19′ Aluminum Pole | $12.95 Net per lamp |

**Additional Charges for Optional Installation**

| | Additional Monthly Charge |
|---|---|
| 7,000 Lumen Unit with 8′ Arm | $0.20 Net per unit |
| 7,000, 11,000, 20,000 or 53,000 Lumen Unit with 10′ Arm | $0.50 Net per unit |
| with 12′ Arm | $0.60 Net per unit |
| with 15′ Arm | $0.80 Net per unit |

When service cannot be supplied from the existing distribution system, the Company will, at the customer's request, install poles and spans of wire, which can be connected to an existing secondary circuit, for which the customer will either:

(1) pay in advance the cost of installing such additional facilities, or

(2) pay a monthly rental of $0.53 for each span of overhead secondary circuit not over 150 feet in length, and $1.12 for each standard distribution wood pole required.

## STREET AND HIGHWAY LIGHTING SERVICE RATE SCHEDULE "MV"

**Rate Per Month**

1. For Standard Semi-Enclosed Type Luminaire on 6-Foot Bracket or Less:

   7,000 Lumen ( 700 c.p.) Lamp
   $ 4.70 gross per lamp; $ 4.45 net per lamp

2. For Standard Enclosed Type Luminaire on 8-Foot Bracket or Less:

   11,000 Lumen (1,000 c.p.) Lamp
   $ 6.85 gross per lamp; $ 6.60 net per lamp



   20,000 Lumen (2,000 c.p.) Lamp
   $ 8.95 gross per lamp; $ 8.70 net per lamp
   53,000 Lumen (5,300 c.p.) Lamp
   $15.30 gross per lamp; $15.05 net per lamp

3. Floodlights (Standard) on Brackets:

   11,000 Lumen
   $ 6.85 gross per lamp; $ 6.60 net per lamp
   20,000 Lumen
   $ 8.95 gross per lamp; $ 8.70 net per lamp
   53,000 Lumen
   $15.30 gross per lamp; $15.05 net per lamp

4. Pole Top Mounted 7,000 Lumen MV Lamp:

   on 15′ Steel Pole
   $12.25 gross per lamp; $12.00 net per lamp
   on 20′ Steel Pole
   $13.10 gross per lamp; $12.85 net per lamp
   on 14′ Aluminum Pole
   $12.50 gross per lamp; $12.25 net per lamp
   on 19′ Aluminum Pole
   $13.10 gross per lamp; $12.85 net per lamp

**Additional Charges for Optional Installation**

| | Additional Monthly Charge |
|---|---|
| 7,000 Lumen Unit with 8′ Arm | $0.20 net per unit |
| 7,000, 11,000, 20,000 or 53,000 Lumen Unit with 10′ Arm | $0.50 net per unit |
| with 12′ Arm | $0.60 net per unit |
| with 15′ Arm | $0.80 net per unit |

**Discounts**

The difference between the gross and net rate above specified shall constitute a discount for prompt payment if the account is paid in full on or before the 20th day

after that on which the bill is rendered, provided all bills previously rendered under this schedule have been paid in full.

## STREET AND HIGHWAY LIGHTING SCHEDULE "OSL"

**Rate Per Month**

1. Standard Installation:

| | |
|---|---|
| 100 Candlepower Lamps | $2.65 gross per lamp |
| 250 Candlepower Lamps | 3.05 gross per lamp |
| 400 Candlepower Lamps | 4.15 gross per lamp |
| 600 Candlepower Lamps | 5.25 gross per lamp |
| 1,000 Candlepower Lamps | 9.25 gross per lamp |

Additional Charges for Optional Installation:

| | |
|---|---|
| Mast Arm | $0.08 gross per lamp |
| Span Suspension | .64 gross per lamp |
| Enclosing Globe | .22 gross per lamp |
| Ornamental Fixture | .67 gross per lamp |
| Wiring Enclosed in Fixture | .17 gross per lamp |

2. Special Semi-Enclosed Luminaire Installation on Existing Poles Having Secondary Distribution Facilities Available:

| | |
|---|---|
| 250 Candlepower Lamps | $3.40 net per lamp |
| 400 Candlepower Lamps | 4.30 net per lamp |
| 600 Candlepower Lamps | 6.00 net per lamp |

**Prompt Payment**

A prompt payment discount of 5% will be allowed on the first $700.00 of monthly billing for standard lamps if paid in full on or before the 20th day after that on which the bill is rendered, provided all bills previously rendered under this schedule have been paid in full.



## APPENDIX B

## PUBLIC SERVICE COMMISSION OF WEST VIRGINIA CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA at the Capitol in the City of Charleston on the 20th day of April, 1977.

**Case No. 8127**

MONONGAHELA POWER COMPANY,
a corporation.

In the matter of increased rates and charges.

## ORDER ON PETITION FOR REHEARING, REARGUMENT AND RECONSIDERATION OF COMMISSION'S ORDER OF MARCH 18, 1977

The respondent, Monongahela Power Company ("Monongahela"), filed a petition on March 28, 1977, pursuant to Rule 19 of the Commission's Rules of Practice and Procedure, to reopen this proceeding for rehearing, reargument and reconsideration of the order of the Commission dated March 18, 1977, and assigned certain grounds therefor.

Upon consideration of said petition and the order of March 18, 1977, the Commission finds that certain clarification of its holdings and reasons for the same should be appropriate wherein it passed upon the following issues that have been raised in Monongahela's petition: 1. Effect upon Financing for Construction and Reliability of Service; 4. Pollution Control Related Additions; 7. Davis Power Project; 8. Allowance for Working Cash; 9. Operation and Maintenance Expense on Pollution Facilities; 12. Rate Structure (Electric Water Heater Rate); and 14. Refund.

**1. Effect upon Financing for Construction and Reliability of Service**

Company contends that the Commission's order makes it impossible to "attract capital on a reasonable basis". This is not supported by the record in this case or by data supplied by Monongahela Power with its petition for reconsideration. The Commission has found that the rates granted will provide a reasonable rate of return and the evidence did not show Monongahela to be in a position of having an inability to finance its needed construction.

Monongahela's figures show that the Commission's allowed rates gave adequate interest coverage in 1976.

The Company's own projections into 1977 (although unsubstantiated and of no evidentiary value) indicate that the capital requirements of $113,350,000 can be financed by internally generated funds of $52,450,000 and $60,900,000 of external financing under the Commission ordered rates. Although it is not shown in Monongahela's petition, they, on November 30, 1976, filed Case No. 8809 and the rates requested therein will become effective April 28, 1977, under bond and subject to final approval. This filing makes the future effect of rates involved herein academic since the new rates will soon be effective and the financing problems of 1978 and later years will be met in that filing and not in Case No. 8127.

**4. Pollution Control Related Additions**

With regard to this item, the Commission excluded $3,226,153 of equipment other than electrostatic precipitators which Company contends is necessary to meet environmental requirements. We did allow $15,633,675 for electrostatic precipitators that were not in service during the test period. Of the $3,226,153, $3,203,884 relates to the construction of a coal unloading and additional rail



facilities at the Company's Willow Island plant. In our opinion such a facility does not fall within the classification of equipment required to meet environmental requirements, while being neither revenue producing nor expense reducing in nature. This type of investment is *not* closely related to the precipitator investment which we have found to be non-revenue producing and non-expense reducing. The balance of the disallowed adjustment, such as coal blending, water cooling, and drain treatment, bears a questionable relationship to air pollution control and is inconsequential since the amount involved would have little, if any, impact upon the final rate levels in this proceeding.

**7. Davis Power Project**

The Davis pump storage properties have not been developed to the place they can be considered as "property held for future use", and in view of our rulings with regard to construction work in progress, it is not classified so as to be included in rate base for rate making purposes.

This Commission has repeatedly held that property of a utility should not be included in rate base until it is used and useful in the utility's business. We have not allowed such property to be included in the rate base until it is completed and serving the Company's subscribers. At such time it will be a proper item to include in rate base and the Company will be entitled to earn a return on its investment.

Since the entry of our order in Case No. 8127 on March 18, 1977, the Federal Power Commission has apparently approved the Davis project but such approval is still exposed to the likelihood of attacks and appellate procedures from environmental and governmental agencies. Nevertheless, our decision on this matter was not governed by the tentative nature of the project but rather our prescribed ratemaking treatment of construction projects.

**8. Allowance for Working Cash**

The Commission, in deciding a proper working capital allowance in a prior Monongahela Power Company case (Case No. 7025), took the question of the lag between receipt of and payment for fuel into consideration. In that proceeding a nineteen-day allowance of coal expense was used and a forty-five day allowance on the remainder of the operation and maintenance expenses less the cost of purchased power was provided for working capital. The evidence in the instant case shows that the fuel cost more properly deserves the same treatment as purchased power because of the time lapse from the date of purchase to the date of payment for the same. Since that lag was shown to be 45 days, fuel expense should be totally eliminated as item of working capital.

**9. Operation and Maintenance Expense on Pollution Facilities**

The Company in its petition apparently has misconstrued the last sentence of our order that deals with operations and maintenance expense on pollution facilities. The Commission allowed an *additional* $233,000, on a total Company basis, to provide for operating expenses associated with pollution control facilities. There was no question or disagreement with regard to the original $124,000 adjustment for maintenance expenses on the same facilities since the $124,000 was reflected in both the Company and staff exhibits. The total allowed operating expenses of $82,254,555, as shown on Appendix I of our order, therefore includes both the *additional* $233,000 and the original $124,000 adjustment.

**12. Rate Structure** (Electric Water Heater Rate)

In a matter of the Company's terminating its water heating rate on May 1, 1974, this item was placed in its



tariff filed in Case No. 7025 dated January 21, 1974, when the Company presented rates in compliance with the order therein, that directed them to design rates to produce a specified amount of additional revenue. It is true that the rates presented would produce the suggested revenues and that this Commission did not reject the water heating cutoff and in fact it was not a matter in issue in that case.

In a subsequent rate proceeding (Case No. 7784) on March 5, 1976, involving a sister company, The Potomac Edison Company of West Virginia, the Commission inquired into the issue of terminating the Company's all-electric home rate. The tariff sought to terminate the heating rate on a specific date and we held, after due hearing on the matter, that such termination was discriminatory and improper. In the instant proceeding the water heating tariff is a similar situation. It was an issue in the current case and after due consideration we have determined that such a cutoff date for water heating is also discriminatory and unjustified. By our order of March 18, 1977, the Commission has rejected this cutoff feature effective as of the date of the order and directs its removal from the tariff approved therein.

**14. Refund**

With regard to the making of refunds the Company is to have the right to apply any refund amount to a delinquent customer's balance, however, it should not treat a customer's account as being delinquent before the refund credit has been applied to his account.

The other items set out in respondent's petition for rehearing, reargument and reconsideration were all taken into consideration by the Commission in reaching its decision in the order of March 18, 1977, and IT IS, THEREFORE ORDERED that the order of March 18, 1977,

except as amended and clarified herein, shall remain in full force and effect, and that respondent's petition for rehearing, reargument and reconsideration is hereby denied.

A COPY.

TESTE:

S. GROVER SMITH, JR.
*Secretary*



*APPENDIX C*

**MONONGAHELA POWER COMPANY**

**CASE NO. 8127**

**COAL STOCKPILE LEVELS**

| | Number Days Supply | Mbtu/Kw of Capacity |
|---|---|---|
| 9-1-70 – 8-31-73 | 87 | 14.2 |
| 9-1-73 – 8-31-74 (test year) | 75 | 10.8 |
| October '74 | 74 | |
| November '74 | 59 | |
| December '74 | 45 | |
| January '75 | 33 | 6.8 |
| February '75 | 41 | 7.4 |
| March '75 | 52 | 8.6 |
| April '75 | 56 | 9.1 |
| May '75 | 65 | 10.4 |
| June '75 | 71 | 12.2 |
| July '75 | 63 | 11.6 |
| August '75 | 61 | 11.7 |
| September '75 | 59 | 11.5 |
| October '75 | 53 | 11.3 |
| November '75 | 55 | 11.4 |
| December '75 | 53 | 11.4 |
| 1-1-75 – 12-31-75* | 55 | 10.3 |

Source: Tr. 1093 - 1096

*Calculated

*APPENDIX D*

## 2. PROVISIONS FOR TAXES

### a. FEDERAL INCOME TAXES

#### (i) Normalization of Liberalized Depreciation

Approximately six million dollars of the company's case is associated with its effort to persuade the Commission to allow normalization accounting for liberalized depreciation on all post 1969 property additions (Tr. 306). Since the Commission is fully aware of the arguments for and against normalization of liberalized depreciation, we will respond only briefly to the specific contentions of the company in this case.

On rebuttal, Mr. Hayes recited a list of six "benefits" accruing from normalization of liberalized depreciation (Resp. Exh. H, pp 14-15). First, he said "by using normalization, the distribution of depreciation expense and related income tax expense over the service-life of the property is far more equitable. That way, customers pay their equal share each year." The other side of the coin, of course, is that normalization requires present customers to pay a far larger FIT component in their rates than is actually incurred by the company, a component inflated even further because the dollars collected are not tax-free dollars. Each dollar collected for future Federal Income Taxes is taxable, so that approximately two dollars must be collected before tax for each one dollar which goes into the reserve (Tr. 1205).

Second, Mr. Hayes argued that under normalization "the cost of service to the customers is less, as we have seen in (Exhibit 14), as a result of lower rate base and lower cost of capital." That statement simply is not true. What Exhibit 14 does show is that with respect to a *single piece of property*, the *return* requirement associated



therewith is smaller over the life of the property than it would be using flow-through, but this is true simply because the rate payer has contributed dollars which, in effect, pay for the piece of property and the shareholders should not be allowed a return component on those dollars since they did not provide them. Mr. Hayes finally agreed on cross that while the *return* requirement may be less under normalization with respect to a particular piece of property, the *revenue* requirement certainly is not (Tr. 1376, 1378), and he was never able to support his assertion that normalization results in a lower cost of capital.

Third, Mr. Hayes argued that "the reserve for deferred taxes provides a source of funds free of debt or equity costs, thereby reducing the amount of funds that have to be raised publicly, as well as the cost of capital." Mr. Hayes fails to recognize that the reserve for deferred taxes is nothing other than capital (he used the term "capital" himself in Resp. Exh. H, p 2, l. 12) conscripted from the rate payers which has several characteristics different from capital raised in the marketplace. First, the capital is not contributed voluntarily; second, the rate payers do not receive a return *on* such capital; and third, the rate payers do not receive a return *of* such capital (through depreciation). Thus not only does it take more dollars to create the reserve (because of the taxability of the reserve collections), but also the provider of this "capital" receives none of the benefits therefrom that would be received had he invested the same amount of money through the normal market processes.

Mr. Hayes next argues that "the ability to raise public funds when necessary is improved in that the amount of public debt is less, and the times-interest coverage is improved," and that "the over-all financial position of the company is improved." Staff does not dispute the fact that if the company is able to raise more money from its rate

payers through normalization than would be the case through flow-through, its financial condition and cash-flow will be improved. The price, of course, is higher rates, part of which go to improve the financial condition of the company and part of which flow to the Federal Government because of increased Federal Income Taxes (Tr. 1206).

Finally, Mr. Hayes argues that an income statement reflecting flow-through is not realistic. That statement is a matter of opinion. A proper income statement will reflect whether normalization or flow-through accounting is being used, and investors or others examining such an income statement may judge for themselves whether it is realistic.

Now that the Federal Power Commission has supported normalization (in Order No. 530-B, which changed its position taken in Order 530-A, which changed its position taken in Order No. 530), the company is quick to cite that forum as authority for its position. Order No. 530-B, however, goes to great lengths to point out that a Commission is free to choose how to treat the effect of timing differences between tax and book accounting (Order No. 530-B, p 4).

The Order also quotes (at p 6) from Order No. 530, wherein the Commission stated:

> The adoption of normalization of income taxes for rate purposes will contribute to the health of the electric and natural gas industries by increasing cash flow and by reducing *external financing requirements.* In addition, normalization will contribute to the financial stability of companies and improved *fixed charge* coverages. (Italics supplied)

With respect to Monongahela's current external financing requirements, the Commission will note that in Case No. 7025, then-Executive Vice President and General Manager



of Monongahela, L. S. Singley, testified Case No. 7025, Tr. 33):

> Since our revenues presently provide only approximately 20% of the money needed for our construction programs, large amounts of new capital must be obtained from outside sources.

At Staff Counsel's request, Mr. Shay provided an analysis of the amount of internally generated fund available for the company's construction program. The information, provided by letter dated April 30, 1976, indicates that from 1973 to 1975, internal funds supplied from 30.3% (in 1974) to 44.5% (in 1975) of the money needed for gross property additions. These results were reached without normalization of liberalized depreciation and indicate a substantially higher current percentage of internally generated funds available for construction than existed when Mr. Singley testified in Case No. 7025.

With respect to fixed-charge coverages, Appendix B, Tables 1-3, attached hereto and further described below, indicate that Monongahela Power Company has far outpaced the industry with respect to pre-tax interest coverage, post-tax interest coverage and post-tax overall coverage from 1970 through 1975.

For all of these stated reasons, staff opposes approval of normalization for liberalized depreciation for Monongahela Power Company for ratemaking purposes.

**(i) Job Development Credits**

This matter has already been discussed herein, *supra,* at page 14.

**(iii) Additional Tax Depreciation**

Since Monongahela files its federal income tax return on a calendar year basis, the calculation of test year (TME 9-30-74)

## APPENDIX C

STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 12th day of September, 1977, the following order was made and entered, to-wit:

Monongahela Power Company, a corporation

vs.

Public Service Commission of West Virginia

Upon an appeal from, suspension and review of the final orders of the Public Service Commission of West Virginia made and entered on March 18 and April 20, 1977.

The Court, having maturely considered the petition and exhibits; note of argument in support thereof, and joint supplemental note of argument in support thereof; the record consisting of all papers, documents and evidence which were before the Public Service Commission at the hearing which resulted in the entry of the final orders complained of; the statement of reasons for the entry of its orders of the 18th day of March and 20th day of April, 1977, filed herein by the respondent, Public Service Commission of West Virginia, on July 11, 1977; and the oral argument of counsel on the 12th day of July, 1977, the date fixed by the Court for hearing upon the aforesaid petition; is of opinion that the petitioner has not shown itself entitled to the relief prayed for in its said petition. It is therefore considered and ordered that the prayer of the petition for an appeal from, suspension and review, in this proceeding, be, and the same is hereby denied.

It is further ordered that leave be, and the same is hereby granted to the Public Service Commission of West Virginia to withdraw from the office of the Clerk of this

Court, the record consisting of all papers, documents and evidence originally filed with the Public Service Commission of West Virginia. Justice Harshbarger absent.

A True Copy

Attest:

Clerk Supreme Court of Appeals



# APPENDIX D

## [¶ 36,675] Statement of Policy Regarding First Mortgage Bonds Subject to the Public Utility Holding Company Act of 1935

**Release No. 35-13105, February 16, 1956, 21 F. R. 1286.**

**Reg. § 251.13105.** The Securities and Exchange Commission in acting upon applications under Section 6(b) and declarations under Section 7 of the Public Utility Holding Company Act of 1935 filed in respect of issues of first mortgage bonds of public-utility companies has required issuers to include in indentures various protective provisions.

**[¶ 36,676] [Standards]**

There has not heretofore been published by the Commission any rule or definitive statement of policy setting forth the standards against which it judges the adequacy of proposed indenture provisions. The Commission believes that such a statement would be in the public interest, and accordingly has formulated the standards set forth herein. The Commission will compare indentures submitted by issuers with these standards in considering (1) whether to impose terms and conditions in granting applications filed under Section 6(b) or (2) whether to make adverse findings in respect of declarations pursuant to Section 7(d). Where the Commission finds that a particular standard should be compiled with, but it is impracticable to include such standard in the indenture, the Commission will impose the standard as a condition in the Commission's order.

**[¶ 36,677] [Deviations]**

The Commission realizes that deviations from these standards should be permitted in appropriate cases. It also realizes that in most cases securities subject to Sections 6 and 7 of the Act will be issued under existing indentures and that to require issuers to conform existing indentures to such standards would in some cases produce harsh results and in other cases add needless complexity to the issuer's problem of complying in respect of several series of bonds with varying provisions relating to the same subject matter. The Commission is mindful of the fact that most securities presently outstanding under such existing indentures were issued after the examination of the indenture by the staff of the Commission and in many cases after the making of changes therein on recommendation of the staff or the Commission. Moreover, substantial amounts of such securities were purchased by and are held by experienced investors and such securities enjoy favorable ratings in the public markets.

**[¶ 36,678] [Additional Securities]**

The Commission therefore has determined that in most cases it would not be inconsistent with protection of the public interest and the interest of investors and consumers to permit the issue of additional securities under an existing indenture if (1) the Commission has heretofore permitted a declaration for the issuance of securities under such indenture to become effective under Section 7 or has heretofore granted an exemption with respect thereto under Section 6(b) and (2) the additional securities will be subject to substantially the same protective

provisions as the most recently issued outstanding securities of the issuer. However, the Commission may suggest changes in an existing indenture to comply with one or more of the proposed standards if by reason of changed or unusual circumstances the probable results of applying the provisions of the existing indenture would in the Commission's opinion require the making of adverse findings under Section 7(d) or the imposition as a condition to granting an exemption under Section 6(b) of a requirement that such changes be made. Moreover, since each supplemental indenture in respect of an additional series of bonds usually involves the restriction of additional surplus, all indenture provisions dealing with that subject will be examined for substantial conformity with the standards hereinafter prescribed. As indicated in the standards, the Commission may permit the amount of earned surplus remaining unrestricted to be larger than one year's dividend requirements on preferred and common stocks if the issuer demonstrates to the Commission that the payment of such larger amount to the common stockholders would not materially and adversely affect existing capitalization ratios or otherwise be inconsistent with the protection of the holders of the securities in the light of the ratio of mortgage debt to net fixed property.

**[¶ 36,679]** **[Property Additions]**

The Commission is interested in ascertaining whether the amount to be expended annually for property additions in compliance with the provisions of existing indentures is a reasonable annual requirement in relation to the book cost and estimated useful life of depreciable mortgaged property. In connection with declarations or applications in respect of additional bonds, the Commission will not, prior to July 1, 1956, require changes in existing clauses relating to renewal and replacement of mortgaged property. Thereafter the Commission will require a showing, on the basis of studies by the issuer, that the existing provisions for renewal and replacement are substantially equivalent to or greater than such amount as would reasonably be required under the standards hereinafter set forth for new indentures.

Neither the renewal and replacement fund requirements nor the sinking and improvement fund requirements, as set forth in this Statement of Policy, will be required to be applied retroactively.

**[¶ 36,680]** **FIRST MORTGAGE BOND INDENTURE PROVISIONS**

The Indenture as supplemented (the Indenture) of the issuer (the Obligor) of the bonds to be authenticated and delivered under the Indenture shall provide that the bonds can be called by the Obligor for redemption at any time upon reasonable notice and with reasonable redemption premiums, if any.

The Indenture shall contain provisions which shall not be less favorable to the holders of the bonds than the following:

**[¶ 36,681]** **Issuance of Additional Bonds**

(a) Additional bonds may be authenticated and delivered under the Indenture in a principal amount not in excess of

(1) a like amount of cash deposited with the Indenture Trustee;

(2) a like principal amount of retired bonds, or



(3) sixty per centum (60%) of the bondable value of net property additions;

provided that net earnings available for the payment of interest during any twelve (12) consecutive calendar months during the period of fifteen (15) calendar months immediately preceding the first day of the month in which application is made to the Indenture Trustee for the authentication and delivery of such additional bonds shall be at least equal to twice the annual interest requirements on all bonds authenticated and delivered under the Indenture and prior lien obligations which will be outstanding immediately after the authentication and delivery of such additional bonds. Notwithstanding any of the foregoing, no earnings test need be met if such additional bonds are to be authenticated and delivered solely for the purpose of refunding an outstanding series of bonds issued under the Indenture or prior lien

**[¶ 36,681]** **Reg. § 251.13105**—Continued

obligations, bearing a higher interest rate than such additional bonds, or for refunding an outstanding series of bonds issued under the Indenture or prior lien obligations within two years of maturity.

**[¶ 36,682]** **Sinking and Improvement Fund**

(b) The Indenture shall have the effect of requiring the Obligor to deposit annually with the Indenture Trustee an amount of cash equal to not less than one per centum (1%) of the aggregate principal amount of bonds of all series authenticated and delivered under to Indenture. Such requirement may, at the option of the Obligor, be stated separately for each series of bonds or be stated on an omnibus basis for all series.

(c) In determining the aggregate principal amount of bonds of all series authenticated and delivered under the Indenture, there may be excluded

(1) a series of bonds which has been retired, if the sinking and improvement fund with respect thereto was operative only so long as such series was outstanding;

(2) in all other cases, bonds authenticated and delivered under the Indenture on the basis of retired bonds;

(3) bonds authenticated and delivered under the Indenture which have been redeemed or purchased by the application of moneys deposited with the Indenture Trustee in connection with releases of property or on account of the damage or destruction of property; and

(4) bonds authenticated and delivered under the Indenture which have been pledged to secure indebtedness of the Obligor but which have not otherwise been issued to the public.

(d) In lieu of cash, the Obligor at its option may apply against the sinking fund requirement an amount equal to

(1) the principal amount of retired bonds; or

(2) sixty per centum (60%) of the bondable value of net property additions.

(e) The Obligor shall be required to meet its initial obligation under the sinking and improvement fund relating to the series of bonds to be authenticated and delivered under the Indenture not later than twenty-three (23) months from the date of said series of bonds.

[¶ 36,683] **Renewal and Replacement Fund**

(f) The Obligor shall expend annually for property additions an amount which the Obligor has demonstrated to the Commission is a reasonable annual requirement for the replacement of the book cost of depreciable mortgaged property of the Obligor which amount shall be expressed in terms of a percentage of said book cost. Such annual expenditure requirement may be satisfied, in whole or in part, by expenditures for property additions made in a previous period.

(g) If the Obligor shall have failed to satisfy such annual expenditure requirement, the Obligor shall deposit cash with the Indenture Trustee to the extent of such deficiency; provided, however, that the amount of cash required to be deposited may be reduced by an amount equal to the principal amount of retired bonds.

[¶ 36,684] **Limitation on Dividends**

(h) The Obligor shall not*

(1) declare any dividends or make any distributions in respect of outstanding shares of its common stock (other than dividends in shares of its common stock); or

(2) purchase or otherwise acquire for value, either directly or indirectly through a subsidiary, any outstanding shares of its common stock otherwise than in exchange for or out of the proceeds from the sale of other shares of its common stock

if the total amount of such dividends, distributions, purchases and acquisitions (all of which are hereinafter in this paragraph embraced in the word "dividends"), together with all other such dividends subsequent to the date of the series of bonds to be authenticated and delivered under the Indenture, exceeds, without giving effect to any of such dividends, or to any net transfers from earned surplus to stated capital accounts, the sum of (i) the earned surplus accumulated since said date, (ii) an amount equal to approximately the current annual dividend payments on the outstanding shares of preferred stock and common stock of the Obligor (including any shares then proposed to be issued), and (iii) such additional amounts the payment of which the Obligor has demonstrated to the Commission would not materially and adversely affect existing capitalization ratios or otherwise be inconsistent with the protection of the holders of the securities of the Obligor in the light of the ratio of mortgage debt to net fixed property.

[¶ 36,685] **Property Additions Subject to a Prior Lien and Prior Lien Obligations**

(i) Property additions which are subject to a lien prior to the lien of the Indenture may be used by the Obligor for any purpose under the Indenture provided that there is deducted from the amount of such property additions an amount at least equal to 166⅔% of the principal amount of outstanding prior lien obligations secured by such prior lien and such other deductions

* [For modification of this policy, see ¶ 36,688. CCH.]



as may be required under the Indenture and provided, further, that if such property additions are used as the basis for the authentication and delivery of bonds under the Indenture or the withdrawal from the Indenture Trustee of cash made the basis for the authentication and delivery of bonds under the Indenture, there shall be deposited with the Indenture Trustee (unless the issuance and deposit thereof are invalid) a principal amount of prior lien obligations not theretofore issued under the prior lien instrument at least equal to the principal amount of such bonds or cash.

(j) From and after the date of acquisition by the Obligor of property additions subject to a prior lien, prior lien obligations may not be issued under the instrument establishing such prior lien except for the purpose of delivery to the Indenture Trustee.

(k) After deduction shall have been made as set forth in paragraph (i) above on account of any outstanding prior lien obligations, the Obligor may use such prior lien obligations, upon the deposit thereof with the Indenture Trustee or their payment, redemption or retirement for the same purposes under the Indenture and to the same extent that retired bonds may be used.

[¶ 36,686] **Definitions and Miscellaneous**

(l) The amount of property additions shall be the cost to the Obligor or the fair value to the Obligor, whichever is less, of gross property additions. The fair value may be determined either as of the date of acquisition or the date of certification to the Indenture Trustee, whichever is appropriate in the light of other provisions of the Indenture.

(m) The bondable value of net property additions shall be determined after excluding or deducting from the amount of property additions an amount of property additions equal to the greater of retirements (less credits for cash or other substitutions) or the amount required to be expended for property additions pursuant to the renewal and replacement fund.

(n) To the extent property additions, cash, bonds, retired bonds, prior lien obligations and other property have, under a particular provision of the Indenture, been made the basis of a credit or for action by the Indenture Trustee, they may not be made the basis of a credit or for action by the Indenture Trustee under another provision of the Indenture. The provisions of this paragraph are designed to prohibit duplication of credits but they are not intended to preclude, for example, the certification of property additions (to the extent not theretofore used as the basis of a credit or for action by the Indenture Trustee) for the release of property additions which were likewise not so used and the subsequent inclusion of the property additions so certified in the computation of the bondable value of net property additions.

(o) Bonds authenticated and delivered under the Indenture and prior lien obligations which in either case have been purchased or retired with moneys or other property constituting a part of the trust estate under the Indenture shall not be used by the Obligor for any purpose under the Indenture except as otherwise herein provided.

(p) Retired bonds shall mean bonds authenticated and delivered under the Indenture which have been paid at maturity or upon redemption or have been purchased or otherwise acquired, and have been surrendered to the

Indenture Trustee and cancelled or for which funds are held by the Indenture Trustee for any of such purposes; provided, however, that retired bonds shall not include bonds theretofore authenticated and delivered under the Indenture which have been retired with moneys or other property constituting part of the trust estate under the Indenture.

(q) The net earnings of the Obligor available for the payment of interest shall be the amount of income remaining after deducting from the gross operating revenues of the Obligor all operating expenses of the Obligor including depreciation and taxes (other than taxes based on income) and after adding or deducting, as the case may be, net non-operating income or loss. The amount of net non-operating income or loss to be taken into account shall not exceed ten per centum (10%) of the balance of income remaining before consideration of such net non-operating income or loss.

(r) Any amounts representing amortization of electric or gas plant acquisition adjustments charged to income or charged to earned surplus in lieu of income shall be deducted in the computation of earnings available for the payment of interest only to the extent that the current provision for depreciation with respect to depreciable property shall be insufficient to permit the write-off of depreciable property (together with amounts classified as plant acquisition adjustments) at the expiration of the estimated useful life thereof.

(s) If the renewal and replacement fund requirement shall exceed the amount required to be deducted on account of depreciation plus the amount, if any, required to be deducted in accordance with paragraph (r) above, such excess shall also be deducted in the computation of earnings available for the payment of interest.

(t) Earned surplus which has been restricted in respect of the payment of dividends on, or the making of distributions with respect to, or the acquisition of, outstanding shares of the common stock of the Obligor may be debited or credited in respect of items inherent in the enterprise at the date as of which such earned surplus was restricted and debited in respect of transfers to capital.

(u) For purposes of determining earned surplus accumulated after the date as of which earned surplus shall have been restricted, there shall be included as charges applicable to the period subsequent to such restriction date the dividends on the outstanding shares of the preferred stock of the Obligor accruing subsequent to said date and the amount, if any, by which the aggregate of the expenditures required to be made by the Obligor subsequent to said date for property additions pursuant to the renewal and replacement fund shall exceed the aggregate for said period of

(1) the provisions made on its books of account in respect of depreciation; and

(2) amounts representing write-off, amortization, or provision for reserves in respect of plant acquisition adjustments, whether accounted for through the income account or through the earned surplus account, to the extent that such amounts pertain to items not inherent in the enterprise prior to the date as of which earned surplus has been restricted.

(v) In appropriate cases, the provision of the Indenture may be drawn so as to permit the use of consolidated data in complying with the requirements of the Indenture.



**[¶ 36,687] Trust Indenture Act Provisions**

(w) None of the provisions of the Indenture shall be in contravention of provisions required to be included, pursuant to Sections 310 to 317 of the Trust Indenture Act of 1939, in indentures qualified under said Act.

[Release No. 35-13105, February 16, 1956, 21 F. R. 1286.]

## [¶ 36,688] First Mortgage Bond Redemption Policies

**Release No. 35-16369, May 8, 1969, 34 F. R. 9553.**

**17 CFR 251.16369.** On November 20, 1968 the Securities and Exchange Commission published an invitation for comments (Release No. 35-16211) on the question of whether it should modify those provisions of its Statement of Policy Regarding First Mortgage Bonds Subject to the Public Utility Holding Company Act of 1935 (Release No. 35-13105) which heretofore have required that bonds issued and sold pursuant to the terms of Sections 6 and 7 of such Act ("Act") be redeemable at the option of the issuer "at any time upon reasonable notice and with quirement now contained in its Statement of Policy Regarding First Mortgage Bonds Subject to the Public Utility Holding Company Act of 1935 (Release No. 35-13105), so that issuers may include in the indentures securing new issues of mortgage bonds a provision prohibiting, for a period of not more than five years, the refunding of such bonds by the issuance of debt securities at lower interest costs.

Heretofore, the general redemption prices of first mortgage bonds have been considered reasonable, within the meaning of the Statement of Policy, whenever such general redemption prices commence, immediately following the issuance of such bonds, at an amount equal to the sum of the coupon rate plus the public offering price and decline each year thereafter by equal amounts to the principal amount at the beginning of the last year prior to maturity. No change in this policy is authorized. Therefore, when the five-year period of non-refundability authorized herein expires, the general redemption price at which the bonds may then be called will be the same as it would have been if there had been no restriction on refundability.

reasonable redemption premiums, if any." A number of persons have submitted comments.

The Commission has concluded that it is appropriate, in the public interest and in the interest of investors and consumers, to permit the issuers of first mortgage bonds subject to the Act to include a five-year refunding limitation in the terms and provisions of new issues of such bonds. Accordingly, pursuant to the provisions of Sections 6, 7 and 20 of the Act, the Commission has suspended the redemption re-

The modification of redemption policy herein authorized shall not apply to the redemption of first mortgage bonds for sinking fund, or to redemptions in connection with mergers, sales of properties, or for other corporate purposes.

The foregoing modification of redemption policy shall also be applicable to other long-term debt securities issued and sold pursuant to Sections 6 and 7 of the Act.

The Commission wishes to emphasize that it will continuously review the effects of its redemption policies, including specifically the foregoing modification, and based on experience with the modification make such adjustments in these policies as may from time to time be deemed appropriate, including a rescission of the present modification, an extension of the allowed five-year non-refunding period, or any other change experience would warrant.

The modification of policy as to refundability herein authorized shall become effective on May 8, 1969.

[Release No. 35-16369, May 8, 1969, 34 F. R. 9553.]

## [¶ 36,691] Statement of Policy Regarding Preferred Stock Subject to the Public Utility Holding Company Act of 1935

**Release No. 35-13106, February 16, 1956, 21 F. R. 1288.**

**17 CFR 251.13106.** The Securities and Exchange Commission in acting upon applications under Section 6(b) and declarations under Section 7 of the Public Utility Holding Company Act of 1935 filed in respect of issues of preferred stock by public-utility companies has required issuers to include various protective provisions in charters, by-laws or related instruments (hereinafter referred to as "charters").

There has not heretofore been published by the Commission any rule or definitive statement of policy setting forth the standards against which the Commission judges the adequacy of such provisions. The Commission believes that such a statement would be in the public interest and accordingly has formulated the standards set forth herein. The Commission will compare charters submitted by issuers with these standards in considering (1) whether to impose terms and conditions in granting applications filed under Section 6(b) or (2) whether to make adverse findings in respect of declarations pursuant to Section 7(d). The Commission recognizes that deviations from these standards should be permitted in appropriate cases.

In many cases a new series of preferred stock will be issued under existing charter provisions which prescribe the rights, preferences and privileges of the class of stock of which the new series is a part. In such a case, if the existing charter provisions do not conform substantially to the standards set forth herein, and if the issuer should decide that it would be unduly inconvenient or impracticable to convene a meeting of its stockholders prior to the



issuance of the new series for the purpose of amending its charter to effect compliance with the standards, the Commission would expect to apply the standards by the imposition of a condition to that effect in its order permitting the issuer's declaration to become effective or granting its application for exemption. The condition would be drafted to operate only so long as the issuer's charter was not amended to comply with the standards. The Commission, however, would expect the issuer to present such an amendment to its stockholders for approval on the next date on which a meeting of stockholders was being held for any other purpose.

## [¶ 36,692] PREFERRED STOCK CHARTER PROVISIONS

The charter of the issuer (the Corporation) of the preferred stock (meaning the class under consideration) shall provide that the dividends on such stock shall be cumulative, and that such stock can be called by the Corporation for redemption at any time upon reasonable notice and with reasonable redemption premiums, if any.*

The terms and provisions of the preferred stock shall not be less favorable to the holders thereof than the following:

* [For modification of this policy, see ¶ 36,702. CCH.]



## [¶ 36,693] Rights of Holders of the Preferred Stock to Elect Directors

(a) If and when dividends on any series of the preferred stock shall be in arrears in an amount equal to four full quarter-yearly payments or more per share, the holders of all series of the preferred stock voting together as a class shall be entitled to elect the smallest number of directors necessary to constitute a majority of the full board of directors until such time as all dividend arrears on the preferred stock shall have been paid or declared and set apart for payment.

(b) Whenever the right to elect directors shall have accrued to the holders of the preferred stock, the proper officers of the Corporation shall call a meeting for the election of directors, such meeting to be held not less than 45 days and not more than 90 days after the accrual of such right.

[¶ 36,694] **Issuance of Securities Representing Unsecured Debt**

(c) Without the consent of the holders of at least a majority of the total number of shares of the preferred stock outstanding, the Corporation may not issue or assume any unsecured notes, debentures or other securities representing unsecured debt (other than for the purpose of refunding or renewing outstanding unsecured securities issued or assumed by the Corporation resulting in equal or longer maturities or redeeming or otherwise retiring all outstanding shares of the preferred stock) if immediately after such issue or assumption (1) the total outstanding principal amount of all unsecured notes, debentures or other securities representing unsecured debt of the Corporation will thereby exceed 20% of the aggregate of all existing secured debt of the Corporation and the capital stock, premiums thereon, and surplus of the Corporation, as stated on its books, or (2) the total outstanding principal amount of all unsecured notes, debentures or other securities representing unsecured debt of the Corporation of maturities of less than 10 years will thereby exceed 10% of such aggregate.

(d) For the purposes of paragraph (c) above, the payment due upon the maturity of unsecured debt having an original single maturity in excess of 10 years or the payment due upon the final maturity of any unsecured serial debt which had original maturities in excess of 10 years shall not be regarded as unsecured debt of a maturity of less than 10 years until such payment shall be required to be made within 3 years.

[¶ 36,695] **Limitation on Junior Stock Dividends**

(e) The Corporation shall not declare any dividends or make any distributions in respect of outstanding shares of any stock (herein called junior stock) of the Corporation ranking junior to the preferred stock as to dividends or assets, other than dividends in shares of junior stock, or purchase or otherwise acquire for value any outstanding shares of junior stock (each such dividend, distribution, purchase or acquisition being herein called a junior stock dividend) in contravention of the following:

(1) If and so long as the junior stock equity at the end of the calendar month immediately preceding the date on which a dividend on the junior stock is declared is, or as a result of such dividend would become, less than 20% of total capitalization, the Corporation shall not declare such dividends in an amount which, together with all other dividends on the junior stock paid within the year ending with and including the date on which such dividend is payable, exceeds 50% of the net income of the Corporation available for dividends on the junior stock for the twelve full calendar months immediately preceding the calendar month in which such dividends are declared, except in an amount not exceeding the aggregate of dividends on the junior stock which under the restrictions set forth above in this subdivision (1) could have been, and have not been, declared; and

(2) If and so long as the junior stock equity at the end of the calendar month immediately preceding the date on which a dividend on junior stock is declared is, or as a result of such dividend would become, less than 25% but not less than 20% of total capitalization, the Corporation shall not declare dividends on the junior stock in an amount which, together with all other dividends on the junior stock paid within the year ending with and including the date on which such dividend is payable, exceeds 75% of the



[¶ 36,695] **Reg. § 251.13106**—Continued

net income of the Corporation available for dividends on the junior stock for the twelve full calendar months immediately preceding the calendar month in which such dividends are declared, except in an amount not exceeding the aggregate of dividends on the junior stock which under the restrictions set forth above in subdivision (1) and in this subdivision (2) could have been, and have not been, declared.

(f) As used herein, "junior stock equity" shall mean the aggregate of the par value of, or stated capital represented by, the outstanding shares of junior stock, all earned surplus, capital or paid-in surplus, and any premiums on the junior stock then carried on the books of the Corporation, less

(1) the excess, if any, of the aggregate amount payable on involuntary liquidation of the Corporation upon all outstanding shares of preferred stock of the Corporation of all classes over the sum of (i) the aggregate par or stated value of such shares and (ii) any premiums thereon;

(2) any amounts on the books of the Corporation known, or estimated if not known, to represent the excess, if any, of recorded value over original cost of used or useful utility plant; and

(3) any intangible items set forth on the asset side of the balance sheet of the Corporation as the result of accounting convention, such as unamortized debt discount and expense; provided, however, that no deductions shall be required to be made in respect of items referred to in subdivisions (2) and (3) of this paragraph (f) in cases in which such items are being amortized or are provided for, or are being provided for, by reserves.

(g) As used herein "total capitalization" shall mean the aggregate of

(1) the principal amount of all outstanding indebtedness of the Corporation maturing more than 12 months after the date of issue thereof; and

(2) the par value or stated capital represented by, and any premiums carried on the books of the Corporation in respect of, the outstanding shares of all classes of the capital stock of the Corporation, earned surplus, and capital paid-in surplus, less any amounts required to be deducted pursuant to subdivisions (2) and (3) of paragraph (f) above in the determination of junior stock equity.

[¶ 36,696] **Merger or Consolidation**

(h) Without the consent of the holders of at least a majority of the total number of shares of the preferred stock outstanding, the Corporation shall not merge or consolidate with or into any other corporation or sell or otherwise dispose of all or substantially all of its assets unless such merger, consolidation, sale or other disposition or the issuance or assumption of securities in the effectuation thereof shall have been ordered or approved under the Public Utility Holding Company Act of 1935.

[¶ 36,697] **Alteration of Preferred Stock Provisions**

(i) Without the consent of holders of at least two-thirds of the total number of shares of the preferred stock at the time outstanding, the Corporation shall not amend, alter, or repeal any of the rights, preferences or powers of the holders of the preferred stock so as to affect adversely any such rights, preferences or powers; provided, however, that if such amendment,

alteration or repeal affects adversely the rights, preferences or powers of one or more, but not all, series of preferred stock at the time outstanding, only the consent of the holders of at least two-thirds of the total number of outstanding shares of all series so affected shall be required; and provided, further, that an amendment to increase or decrease the authorized amount of preferred stock or to create or authorize, or increase or decrease the amount of, any class of stock ranking on a parity with the outstanding shares of the preferred stock as to dividends or assets shall not be deemed to affect adversely the rights, preferences or powers of the holders of the preferred stock or any series thereof.

**[¶ 36,698] Issuance of Additional Preferred Stock**

(j)(1) Without the consent of the holders of at least two-thirds of the total number of shares of the preferred stock outstanding, the Corporation shall not create or authorize any shares of any class of stock ranking prior to the preferred stock as to dividends or assets or issue any shares of any such prior ranking stock more than 12 months after the date as of which the Corporation was empowered to create or authorize such prior ranking stock.

(2) Without the consent of the holders of at least a majority of the total number of shares of the preferred stock outstanding, the Corporation shall not issue any additional shares, or reissue any reacquired shares, of preferred stock or of any other class of stock ranking on a parity with the outstanding shares of the preferred stock as to dividends or assets for any purpose other than to refinance an equal par amount or stated value of preferred stock or of stock ranking prior to or on a parity with the preferred stock as to dividends or assets at the time outstanding, unless

(i) the gross income of the Corporation (after all taxes including taxes based on income) for 12 consecutive calendar months within a period of 15 calendar months immediately preceding the calendar month of such issuance is equal to at least 1½ times the aggregate of the annual interest charges on indebtedness of the Corporation (excluding interest charges on indebtedness to be retired by the application of the proceeds from the issuance of such shares) and the annual dividend requirements on all preferred stock (including dividend requirements on any class of stock ranking prior to or on a parity with the shares to be issued, as to dividends or assets), which will be outstanding immediately after the issuance of such shares; and

(ii) the aggregate of the junior stock equity is at least equal to the aggregate amount payable in connection with an involuntary liquidation of the Corporation with respect to all shares of the preferred stock and all shares of stock, if any, ranking prior thereto or on a parity therewith as to dividends or assets, which will be outstanding immediately after the issuance of such shares of preferred stock or stock ranking on a parity therewith.

(k) If for the purposes of meeting the requirements of clause (ii) of subdivision (2) of paragraph (j) above, it shall have been necessary to take into consideration any earned surplus of the Corporation, the Corporation shall not thereafter pay any dividends on or make any distributions in respect of, or purchase or otherwise acquire for value, junior stock which would result in reducing the junior stock equity to an amount less than the amount payable on involuntary liquidation of the Corporation with respect to all shares of the preferred stock and all shares ranking prior to or on a parity with the preferred stock as to dividends or assets, at the time outstanding.

**[The next page is 26,637-3.]**



**(l) If, during the period as of which gross income is to be determined for the purpose set forth in paragraph (j) above, the amount, if any, required to be expended by the Corporation for property additions pursuant to a renewal and replacement fund or similar fund established under its mortgage indenture shall exceed the amount deducted in the determination of such gross income on account of depreciation and amortization of electric or gas plant acquisition adjustments, such excess shall also be deducted in determining such gross income.**

**[¶ 36,699] Acquisition or Redemption of Preferred Stock**

**(m) Should the Corporation be in arrears with respect to dividends on the preferred stock it shall not acquire any shares of the preferred stock (except by redemption of all shares of the preferred stock) unless approval is obtained under the Public Utility Holding Company Act of 1935.**

**[¶ 36,700] Voluntary Liquidation Preference**

**(n) The amount payable upon voluntary liquidation of the Corporation to the holder of each share of the preferred stock shall be equal to the then current redemption price of such share.**

**[¶ 36,701] Miscellaneous**

**(o) In appropriate cases, the provisions of the charter may be so drawn as to permit the use of consolidated data in complying with the requirements of the charter.**

**(p) No share of preferred stock shall be "outstanding" within the meaning of paragraphs (c), (h), (i) and (j) hereof if, at or prior to the time when the consent therein referred to would otherwise be required, provision shall be made for its redemption.**

**[Release No. 35-13106, February 16, 1956, 21 F. R. 1288.]**

## [¶ 36,702] Adoption of Modification of Policy Regarding Redemption Provisions of Preferred Stocks Issued and Sold Under the Public Utility Holding Company Act of 1935

**Release No. 35-16758, June 22, 1970, 35 F. R. 10585.**

**17 CFR 251.16758.** On April 20, 1970 the Securities and Exchange Commission published an invitation for comments (Release No. 35-16685) on the question of whether it should modify those provisions of its Statement of Policy Regarding Preferred Stock Subject to the Public Utility Holding Company Act of 1935 ("Act") (Release No. 35-13106) which heretofore have required that preferred stocks issued and sold pursuant to the terms of Sections 6(b) and 7 of the Act be redeemable by the issuer "at any time upon reasonable notice and with reasonable redemption premiums, if any," A number of persons have submitted comments.

The Commission has concluded that it is appropriate, in the public interest and in the interest of investors and consumers, to permit the issuers of preferred stock subject to the Act to include a five-year refunding limitation in the terms and provisions of new issues of such securities. Accordingly, pursuant to the provisions of Sections 6(b), 7 and 20 of the Act, the Commission has suspended the redemption requirement now contained in its afore-

[¶ 36,702] 17 CFR 251.16758—Continued

said Statement of Policy Regarding Preferred Stock, so that issuers may include in the charters, by-laws or related instruments ("Charters") defining the rights, preferences and privileges of new issues of preferred stock a provision prohibiting, for a period of not more than five years, the refunding of such stock by the issuance of debt securities at lower interest costs or other preferred stocks at lower dividend costs.

Heretofore, the general redemption prices of preferred stocks have been considered reasonable, within the meaning of the Statement of Policy, whenever such general redemption prices do not exceed the sum of the initial public offering price plus (1) 100% of the annual dividend rate during the first five years, (2) 75% of the dividend rate in the second five years, (3) 50% of the dividend rate in the third five years, and (4) 25% of the annual dividend rate for the remainder of the life of the stock. In conformity with this formula, when the five-year period of non-refundability authorized herein expires, the general redemption price at which the preferred stock may then be called should be the same as it would have been if there had been no restriction on refundability.

The modification of redemption policy herein authorized shall not apply to the redemption of preferred stock upon voluntary liquidation, or to redemptions in connection with mergers, sales of properties, or for other corporate purposes. Upon the occurrence of any of these events, the redemption price of the preferred stock shall be the same as it would have been if no restriction on refundability had been authorized.

The Commission wishes to emphasize that it will continuously review the effects of its redemption policies, including specifically the foregoing modification, and based on experience with the modification make such adjustments in these policies as may from time to time be deemed appropriate, including a rescission of the present modification, an extension of the allowed five-year non-refunding period, or any other change experience would warrant.

The modification of policy as to refundability herein authorized shall become effective as to all preferred stocks sold on and after June 22, 1970.

[Release No. 35-16758, June 22, 1970, 35 F. R. 10585.]